STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 12601

THE APPLICATION OF BETTIS, BOYLE AND STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

ORDER NO. R-11573-B

ORDER OF THE NEW MEXICO OIL CONSERVATION COMMISSION

BY THE COMMISSION:

This case came before the Oil Conservation Commission (hereinafter referred to as "the Commission") on December 4, 2001 at Santa Fe, New Mexico, and the Commission, having carefully considered the evidence, the pleadings and other materials submitted by the parties hereto, now, on this 15th day of February, 2002,

FINDS,

1. Notice has been given of the application and the hearing on this matter, and the Commission has jurisdiction of the parties and the subject matter herein.

2. On October 23, 2001, Sun-West Oil and Gas Inc. (hereinafter referred to as "Sun-West") filed a timely application pursuant to NMSA 1978, § 70-2-13 for review *de novo* of Order No. R-11573-A of the Oil Conservation Division (hereinafter referred to as "the Division").

3. Order No. R-11573-A provided that the undivided interest owned by Sun-West was to be treated as an unleased mineral interest for the purpose of applying ordering Paragraphs (8), (11) and (12) of Division Order No. R-11573.

4. The Commission's review *de novo* is thus limited to whether Sun-West's interest should be treated as an unleased mineral interest for purposes of ordering paragraphs (8), (11) and (12) of Order No. R-11573 as the Division ordered.

5. The parties stipulated that the record of the Division proceedings would be treated as the Commission's factual record. During the hearing of December 4, 2001, the Commission took official notice of those proceedings but also requested that Sun-West produce additional evidence of its relationship with Gulf Coast. Sun-West accordingly submitted the Affidavit of Shane Spear, President of Sun-West Oil & Gas Inc. and Gulf Coast Oil and Gas Company. Mr. Spears' affidavit should also become a part of the record of this matter.

6. The facts, apparently largely undisputed,[1] are as follows:

a. the Division, in Order No. R-11573, ordered the compulsory pooling of uncommitted mineral interests from the surface to the base of the Undesignated South Flying "M" Bough Pool underlying Lots 3 and 4 (W/2 SW/4 equivalent) in Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico;

b. Bettis, Boyle & Stovall, the applicant for compulsory pooling, proposed to dedicate the pooled acreage to its McGuffin "C" Well No. 1, which it proposed to drill at a standard location in Section 30;

c. at the time the application was filed, Sun-West owned an unleased and undivided 15% mineral interest in Section 30 and had not agreed to voluntary pooling;

d. Bettis, Boyle and Stovall attempted to reach an agreement with Sun-West prior to filing of the application, but Sun-West agreed to lease its interest to Bettis, Boyle & Stovall only for a 25% royalty and additional bonus;

e. when Sun-West failed to agree to voluntary pooling on acceptable terms, Bettis, Boyle and Stovall, on January 30, 2001, filed an application with the Oil Conservation Division for compulsory pooling;

f. notice of the filing of the application of Bettis, Boyle and Stovall and of the hearing thereon was sent by certified mail and received by Sun-West on February 6, 2001;

g. on February 15, 2001, Sun-West executed a lease of its interest in the lands that were the subject of the application in this case to Gulf Coast, reserving to itself a royalty of 27.5%;

[1] Sun-West disputed the finding of the Division that Sun-West and Gulf Coast are affiliates and the findings that the royalty interest reserved to Sun-West rendered the proposed well uneconomic.

h. only the lands within the unit at issue here were included in the lease to Gulf Coast;

i. Sun-West did not participate in the compulsory pooling hearing and appeared through counsel during the second hearing on the re-opened application, but presented no testimony;

j. Bettis, Boyle & Stovall's engineer, Bruce A. Stubbs, testified that Sun-West's 27.5% overriding royalty interest made drilling the McGuffin "C" Well No. 1 unfavorable and undesirable. He testified that while the proposed well would have marginal economics using a 3/16 royalty and yield a 28.13% rate of return before taxes and a 20% rate of return after taxes, a 1/4 royalty would yield a rate of return of 19.18% before taxes. He testified that a well will not be drilled when the rate of return is below 20%;

k. Order No. R-11573 provided for recovery out of production attributable to the interest of non-consenting working interest owners of reasonable well costs of the proposed McGuffin "C" Well No. 1, together with an additional 200% of these costs as a charge for the risk involved in drilling the well;

l. Order No. R-11573 further provided, in ordering paragraph (12), that "[a]ny well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests";

m. on May 3, 2001, Bettis, Boyle and Stovall, apparently having learned of the Sun-West lease to Gulf Coast, filed an application to reopen the case "for the purpose of amending Division Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the non-consent penalty";

n. during the hearing on the application to re-open, Bettis, Boyle and Stovall sought an order permitting it to recover the portion of well costs and of the 200% risk penalty attributable to the mineral interest of Sun-West out of 87.5% of production attributable to such interest as though Sun-West's interest were unleased;

o. Sun-West Oil & Gas Inc. is a Subchapter S corporation incorporated in the State of Texas on December 9, 1991 and its principal place of business is in Hobbs, New Mexico;

p. Gulf Coast is a subchapter C corporation incorporated in Delaware on November 6, 1980 and its principal place of business is in Midland, Texas. Gulf Coast has neither drilled nor operated wells in New Mexico;

q. Shane Spear is the President of both Sun-West and Gulf Coast but the two corporations have differing stock ownership;

r. Sun-West and Gulf Coast share a telephone number and address, and you speak to the same person when you discuss business matters with Sun-West or Gulf Coast;

s. when Bettis, Boyle and Stovall sought to contact Gulf Coast to negotiate terms of pooling, the individual who contacted Bettis, Boyle and Stovall to negotiate on behalf of Gulf Coast was the same individual with whom Applicant had previously discussed leasing of this interest from Sun-West; and

t. the interest of Sun-West in the proposed units was an unleased mineral interest on January 30, 2001, when an application for compulsory pooling of all interests therein was filed, and on February 6, 2001, when Sun-West received notice of the application. The interest of Sun-West was a leased interest as of the dates of the Division's orders.

7. On these facts, Bettis, Boyle & Stovall argued to the Commission that Sun-West's private contract with Gulf Coast improperly sought to avoid the jurisdiction of the Division and the Commission[2] to impose compulsory pooling in appropriate circumstances. Bettis, Boyle & Stovall argued that, but for the lease to Gulf Coast, the Oil and Gas Act would treat Sun-West's interest as an unleased mineral interest with a statutory 1/8 royalty interest and a 7/8 working interest, and the working interest would have been subject to the costs of drilling the McGuffin "C" Unit No. 1 plus a 200% risk penalty. Bettis, Boyle & Stovall claimed that the private contract with Gulf Coast was intended to avoid this result. Bettis, Boyle & Stovall further argued such private contracts could avoid the Division's jurisdiction by permitting a party to free a larger percentage of its interest from the costs of the drilling and create a smaller interest upon which the risk penalty would apply. The net effect of these actions, Bettis, Boyle & Stovall argued, is to reduce the Division's authority under the Oil and Gas Act, and to risk or impair the ability of the party pooling the acreage to produce a viable well because of the fundamental change in the economics wrought by the private contract.

8. Sun-West claimed that the Oil and Gas Act does not permit the Division to retroactively declare its royalty interest unleased. Sun-West claimed that such action would reduce the royalty interest, resulting in a partial taking of its interest and a complete taking of Gulf Coast's interest. Sun-West also claimed that the leasing of its interest was not taken to circumvent the jurisdiction of the Division and that substantial

[2] Further references to "the Division" are also to the Commission. See NMSA 1978, § 70-2-6(B).

evidence is lacking for a finding that Sun-West and Gulf Coast are affiliates. Sun-West also claimed that the Division's consideration of pooling applications is "standardless" and the Division's Order was therefore arbitrary; Sun-West's argument in this regard was based on its reading of Division cases cited as precedent by Bettis, Boyle & Stovall. Sun-West also claims that the Division's Order is not supported by substantial evidence because evidence is lacking to make a finding that the project was not economically viable. Finally, Sun-West claims that Order No. R-11573-A operated retroactively because it related back to the date of filing of the pooling application, not the time of the actual pooling (the entry of the pooling order).

9. It would circumvent the purposes of the Oil and Gas Act to permit a party owning an unleased mineral interest in a spacing unit at the time said party is served with an application for compulsory pooling to avoid the cost recovery and risk penalty provisions of the Act by leasing or otherwise burdening or reducing that interest after the application is filed with the Division and notice is served on the party.

10. Under certain circumstances, leasing, burdening or otherwise carving out a large non-cost-bearing interest may violate the correlative rights of interest owners and create waste if the non-cost-bearing interest is so large as to affect the economic viability of a prospect and prevent the drilling of a well.

11. The Division has repeatedly cautioned parties about carving out excessive non-cost-bearing interests. See R-7335 (interest owners created 50% overriding royalties in conveyances to their son and daughter, and the Division ordered either a voluntary reduction in the overriding royalties or that they be excluded from the proration unit); R-7998 (similar facts and result); R-12087 (a net profits interest carved out by an owner that would unnecessarily burden the project was found to be liable for its proportionate share of drilling and production costs and the risk penalty).

12. The record indicates that the lease to Gulf Coast was intended to circumvent the Division's pooling authority and that the 27.5% royalty interest reserved to Sun-West made the proposed McGuffin "C" Well No. 1 uneconomic and undesirable, threatened the correlative rights of other interest owners and threatens waste.

13. On the first point, uncontroverted evidence[3] indicates that the lease to Gulf Coast was intended to circumvent the Division's pooling authority. For example, counsel for Sun-West drafted and disseminated an article entitled "Compulsory Pooling in New Mexico." That article states that "... parties that anticipate compulsory pooling of their interests *may want to consider carving out or conveying a non-cost bearing burden prior to compulsory pooling. In this way parties being pooled can enhance their position."* A copy of the relevant portions of the article were presented as a demonstrative aid by counsel for Bettis, Boyle & Stovall without objection during the hearing of December 4, 2001, and the Commission takes official notice of a copy of the article.

[3] Sun-West presented no evidence during the three hearings conducted in this matter.

14. The lease of Sun-West's interest to Gulf Coast for a 27.5% royalty strongly suggests implementation of the strategy outlined by Sun-West's attorney in the aforementioned article.

15. Further corroborating is the fact that the non-cost-bearing burden carved out by Sun-West was even greater than the burden demanded by Sun-West of Bettis, Boyle and Stovall during negotiations, and Sun-West carved out and conveyed to Gulf Coast only that portion of its property subject to the pooling application.

16. The timing of the lease (shortly after service of the application for compulsory pooling) is also highly suggestive, as is the fact that Gulf Coast has not drilled or operated wells in New Mexico heretofore, and the close relationship of the two corporations, evidenced by the service of Mr. Spear as President of both and the representation of both by the same individuals. While it is evident that the corporations are separate legal entities, the close relationship of the corporations provided Sun-West a convenient means to implement the strategy described.

17. On the second point, the transaction between Sun-West and Gulf Coast implicates correlative rights and threatens waste. The lease would protect 27.5% of Sun-West's interest from having to bear the costs of drilling and the 200% risk penalty. As the McGuffin "C" Well No. 1 was a marginal economic prospect to begin with, if Sun-West's reserved royalty interest means the well is not drilled and resources underlying Section 30 not recovered, interest owners would be deprived of their statutory opportunity to recover the oil and gas underlying Section 30.

18. Protection of correlative rights and prevention of waste are critical functions of the Division. See NMSA 1978, § 70-2-11. Its authority to regulate in matters relating to conservation of oil and gas production is very broad. NMSA 1978, § 70-2-6.

19. The Oil and Gas Act permits the Division to order compulsory pooling of interests when voluntary efforts are unsuccessful. NMSA 1978, § 70-2-17(C). Section 17 authorizes the Division to require that non-participating parties bear their proportionate share of the costs of development and operations, plus a risk penalty up to 200%. Id. Such orders must be on such terms as are "fair and reasonable," and must protect the opportunity of interest owners to recover or receive without unnecessary expense their fair share of the oil or gas or both. The Oil and Gas Act unambiguously provides that an unleased interest involved in compulsory pooling is treated as being a 1/8 royalty interest and a 7/8 working interest. Id.

20. It appears that a non-cost-bearing burden of 27.5% would render drilling of the McGuffin "C" Well No. 1 unlikely. As noted previously, Bettis, Boyle & Stovall's expert testified that while the proposed well would have marginal economics using a 3/16 royalty interest and yield a 28.13% rate of return after taxes and a 20% rate of return after taxes, a 25% royalty would yield a rate of return of 19.18% *before taxes*. Bettis, Boyle & Stovall's expert testified that a well will not be drilled when the rate of return is below

20% and that Sun-West's higher overriding royalty interest through the Gulf Coast lease made the well unfavorable and undesirable.

21. If the McGuffin "C" Well No. 1 is not drilled as a result of Sun-West's conduct, the correlative rights of the other interest owners would be violated and resources would be left in the earth and wasted.

22. The foregoing argues in favor of treating Sun-West's interest as unleased as ordered by the Division.

23. Sun-West's argument that the Division lacks authority to treat Sun-West's interest as unleased is incorrect for the reasons stated in paragraphs 18 and 19.

24. Sun-West's argument that Order No. R-11573-A creates a partial taking of Sun-West's interest and a complete taking of Gulf Coast's interest is misplaced. It is well established that private contracts in derogation of an oil and gas conservation statute are not enforceable, and that a regulatory body that refuses to recognize such a contract is not taking property in violation of a state constitution or the federal Constitution. Patterson v. Stanolind Oil and Gas Co., 182 Okla. 155, 77 P.2d 83 (Okla. 1938). Sun-West did not tender any evidence to this body tending to support its allegation of a taking; in most cases regulatory action becomes a "taking" only when a property owner is deprived of all or substantially all of the use of the property. Here, a reduced royalty would seem to have the opposite effect given the testimony of Bettis, Boyle & Stovall that the McGuffin "C" Well No. 1 would not be drilled. Reducing non-cost-bearing interests in appropriate circumstances is a well-recognized regulatory tool to ensure that waste is prevented and correlative rights are protected. See 5 Williams & Myers, Oil and Gas Law, § 944, page 680 (2000).

25. Sun-West's argument that the Division's review of compulsory pooling applications is "standardless" and therefore arbitrary is misplaced and based upon a misreading of prior Division cases. The Oil and Gas Act provides detailed standards for examination of applications for compulsory pooling, all of which were considered by the Hearing Examiner in this case and were addressed in detailed findings and conclusions in Order No. R-11573. The cases cited in paragraph 11, above, show that the Division has treated excessive non-cost-bearing interests consistently for many years.

26. Sun-West's argument that no evidence exists that the project was uneconomic also fails. Bruce A. Stubbs testified that a return of less than 20% after taxes results in "unacceptable economics" and "unfavorable economics" and that the higher royalty of the Sun-West lease created a rate of return of 19.18% percent *before taxes*. This more than establishes that the project is not economically viable. Sun-West presented no testimony on this or any other subject and Mr. Stubbs' testimony appears to support the proposition advanced.

27. Sun-West's argument that Order No. R-11573-A operates "retroactively" because it "relates back" to the date of filing of the pooling application, not the time of the actual pooling (the entry of the pooling order) is not valid because it assumes that the jurisdiction of the Division does not attach until issuance of an order. The jurisdiction of the Division attaches once an application for compulsory pooling is filed and the parties are properly served. If Sun-West's premise, that jurisdiction did not attach until the order was issued, is accepted, compulsory pooling could become a process without end and subject to severe abuse.

28. In order to effect pooling of the subject unit on terms that are just and reasonable under these circumstances, and to allow Bettis, Boyle & Stovall the opportunity to recover or receive without unnecessary expense its just and fair share of the oil or gas or both underlying the subject unit, the interest of Sun-West should be treated as an unleased mineral interest for the purpose of applying the cost recovery and risk charge provisions of Division Order No. R-11573.

29. Due to the delay occasioned by the *de novo* review of Order No. R-11573-A, the time for commencement of Applicant's McGuffin "C" Well No. 1, as provided in ordering paragraph (2) of Division Order No. R-11573, should be extended to May 15, 2002.

30. In all other respects, Division Orders No. R-11573 and R-11573-A should remain in full force and effect.

31. The Commission has not been asked to address, nor should it address, any issue regarding rights or duties as between Sun-West and Gulf Coast.

CONCLUSION OF LAW:

The Commission concludes that the authority expressly conferred on the Division and the Commission by the Oil and Gas Act is cumulative and not exclusive, and that the Commission and the Division have authority pursuant to NMSA 1978, §§ 70-2-11(A) and 70-2-17(C) to permit recovery of costs and risk charges out of production attributable to a non-expense-bearing interest where necessary to effect pooling upon terms that are fair and reasonable and to protect correlative rights and prevent waste, at least with respect to interests created subsequent to attachment of the Division's jurisdiction.

IT IS THEREFORE ORDERED:

1. The interest of Sun-West shall be treated as an unleased mineral interest for the purpose of applying ordering Paragraphs (8), (11) and (12) of Division Order No. R-11573.

2. The date for the commencement of Applicant's McGuffin "C" Well No. 1, as provided in Ordering Paragraph (2) of Division Order No. R-11573, is hereby extended to May 15, 2002.

3. In the event the operator does not commence drilling the well on or before May 15, 2002, Ordering Paragraph (2) of Order No. R-11573 shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

4. To the extent not in conflict with this Order, Division Orders No. R-11573 and R-11573-A are hereby confirmed and shall be and remain in full force and effect.

5. Jurisdiction of this case is retained for the entry of such further orders as the Commission may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

LORI WROTENBERY, CHAIR

JAMI BAILEY, MEMBER

ROBERT LEE, MEMBER

S E A L

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

REOPENED
CASE NO. 12601
ORDER NO. R-11573-A

APPLICATION OF BETTIS, BOYLE AND STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on May 31, 2001, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this 24th day of September, 2001, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) On April 26, 2001, pursuant to the Application of Bettis, Boyle and Stovall ("Applicant"), the Division entered Order No. R-11573, providing for the compulsory pooling of all uncommitted mineral interests from the surface to the base of the Undesignated South Flying "M" Bough Pool underlying Lots 3 and 4 (W/2 SW/4 equivalent) in Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico, as therein provided.

(2) Division Order No. R-11573 provided for recovery out of production attributable to the interest of non-consenting working interest owners of reasonable well costs of Applicant's proposed McGuffin "C" Well No. 1, together with an additional 200% of such costs as a charge for the risk involved in drilling such well.

(3) Order No. R-11573 further provided, in ordering paragraph (12), that:

"Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests."

(4) On May 3, 2001, Applicant requested the Division to reopen this case "for the purpose of amending Division Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the non-consent penalty."

(5) In the reopened hearing, Applicant seeks an order allowing it to recover the portion of well costs, and of the 200% risk charge, attributable to the mineral interest of Sun-West Oil & Gas, Inc. ("Sun-West") in the Unit out of 87.5% of production attributable to such interest, as though such interest were unleased, thereby disregarding the terms of a lease from Sun-West Oil & Gas, Inc. to Gulf Coast Oil and Gas Company ("Gulf Coast"), which provides for a royalty of 27.5%.

(6) Applicant presented testimony that:

(a) on the date its application was filed seeking an order pooling the subject units, Sun-West was an owner of an unleased 15% mineral interest in the lands sought to be pooled;

(b) Applicant was unable to reach a voluntary agreement for the development of the subject lands because, although Sun-West was willing to lease its interest in the acreage, it demanded a royalty rate which, in Applicant's opinion, would have rendered the drilling of the proposed well uneconomic;

(c) Applicant proposed to lease Sun-West's mineral interest on terms providing for a royalty of 18.75%, but Sun-West was unwilling to lease to Applicant on those terms. In the opinion of Applicant's expert a larger royalty than 18.75% would render the prospect undesirable;

(d) Applicant filed its application in this case on January 30, 2001;

(e) notice of the filing of the application in this case and of the hearing thereon was sent by certified mail and received by Sun- West on February 6, 2001; and

(f) on February 15, 2001, Sun-West executed a lease of its interest in the lands that were the subject of the application in this case to Gulf Coast, reserving a royalty of 27.5%.

(7) Applicant further presented testimony that:

(a) Gulf Coast has the same address, telephone number and officers as Sun-West; and

(b) when applicant sought to contact Gulf Coast to negotiate terms of pooling of its interest in the proposed Unit, the individual who contacted Applicant to negotiate on behalf of Gulf Coast was the same individual with whom Applicant had previously discussed leasing of this interest from Sun-West.

(8) Sun-West appeared by counsel at the hearing on the re-opened application, but presented no testimony.

(9) The interest of Sun-West in the proposed units was an unleased mineral interest on January 30, 2001, when an application for compulsory pooling of all interests therein was filed, and on February 6, 2001, when Sun-West received notice of the application.

(10) The subsequent lease of the 15% mineral interest from Sun-West to Gulf Coast was not an arms-length transaction, but was consummated for the apparent purpose of increasing the share of production that Sun-West would be entitled to receive free of costs in the event of the entry of a compulsory pooling order by the Division.

(11) NMSA 1978 Section 70-2-17.C provides that:

> "The division is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to all production from such well which would be received by the owner, or owners, for whose benefit the well was drilled or operated, *after payment of royalty as provided in the lease, if any, applicable to each tract or interest*, and obligations payable out of production, until the owner or owners drilling or operating the well or both have been paid the amount due under the terms of the pooling order or order settling such dispute." [Emphasis added.]

(12) However, NMSA 1978 Section 70-2-17.C also provides that:

> "All orders effecting such pooling shall . . . be upon such terms and conditions as are just and reasonable and will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil and gas, or both."
>
> It further provides:
>
> "If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest, ..."

(13) It would circumvent the purposes of the New Mexico Oil and Gas Act (NMSA 1978 Sections 70-2-1 to 70-2-38, as amended) to allow a party owning an unleased mineral interest in the spacing unit at the time said party was served with a compulsory pooling application to avoid the cost recovery and risk charge provisions of the Act by leasing or otherwise burdening or reducing that interest through a transaction with an affiliated entity after the application and notice of hearing are filed with the Division and served on the party.

(14) In previous cases where an interest subject to compulsory pooling carried a burden so large that it could not be pooled in a manner that afforded to other owners in the spacing unit the opportunity to recover their just and fair share of the oil or gas, the Division has allowed the owners of the burdened interest the alternatives of voluntarily reducing the interest not subject to cost recovery or being excluded from the unit. This was done in Division Orders No. R-7335 and R-7988.

(15) The remedy of excluding the burdened interest from the unit is not available in this case because the interest owned by Sun-West is an undivided interest in the entire spacing unit, and not a separate tract.

(16) In order to effect pooling of the subject unit on terms that are just and reasonable under the peculiar circumstance of this case, and to allow Applicant the opportunity to recover or receive without unnecessary expense its just and fair share of the oil underlying the subject unit, the interest of Sun-West should be treated as an unleased mineral interest for the purpose of applying the cost recovery and risk charge provisions of Division Order No. R-11573.

(17) The Division has not been asked to address, and should not address, any issue regarding rights or duties as between Sun-West and Gulf Coast.

(18) Due to the delay occasioned by the reopening of this Case No. 12601, the time for commencement of Applicant's McGuffin "C" Well No. 1, as provided in ordering paragraph (2) of Division Order No. R-11573, should be extended to December 31, 2001.

(19) In all other respects, Division Order No. R-11573 should remain in full force and effect.

CONCLUSION OF LAW:

The Division concludes that the power expressly conferred on the Division by the portion of NMSA 1978 Section 70-2-17.C quoted in finding paragraph (11) is cumulative and not exclusive, and that the Division has power, pursuant to NMSA 1978 Section 70-2-11.A, and to the directive set forth in that portion of Section 70-2-17.C quoted in finding paragraph (12), to allow recovery of costs and risk charges out of production attributable to a non-expense-bearing interest where necessary to effect pooling upon terms that are fair and reasonable and to protect correlative rights, at least with respect to interests created subsequent to attachment of the Division's jurisdiction.

IT IS THERE FORE ORDERED THAT:

(1) Pursuant to the application of Applicant, this Case No. 12601 is reopened for the purpose of reconsidering the allocation of costs and risk charges as to the interest of Sun-West.

(2) Division Order No. R-11573 is hereby amended to provide that the interest owned by Sun-West in the Unit as of the date of the filing of the original application in this case shall be treated as an unleased mineral interest for the purpose of applying ordering Paragraphs (8), (11) and (12) of Division Order No. R-11573, but not otherwise.

(3) The date for the commencement of Applicant's McGuffin "C" Well No. 1, as provided in Ordering Paragraph (2) of Division Order No. R-11573, is hereby extended to December 31, 2001.

(4) In the event the operator does not commence drilling the well on or before December 31, 2001, Ordering Paragraph (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(5) In all other respects, Division Order No. R-11573 is hereby confirmed and shall be and remain in full force and effect.

(6) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Lori Wrotenbery

LORI WROTENBERY
Director

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 12601
ORDER NO. R-11573

APPLICATION OF BETTIS, BOYLE & STOVALL FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on March 22, 2001, at Santa Fe, New Mexico before Examiner Michael E. Stogner.

NOW, on this 26th day of April, 2001, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given and the Division has jurisdiction of this case and its subject matter.

(2) The applicant, Bettis, Boyle & Stovall, seeks an order pooling all uncommitted mineral interests from the surface to the base of the Undesignated South Flying "M" Bough Pool underlying the following acreage in Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico:

(a) Lots 3 and 4 (W/2 SW/4 equivalent) to form a standard 79.73-acre, more or less, stand-up oil spacing and proration unit for any pool within that vertical extent with special rules providing for development on 80-acre spacing, which presently includes only the Undesignated South Flying "M" Bough Pool; and

(b) Lot 3 (NW/4 SW/4 equivalent) to form a standard 39.82-acre oil spacing and proration unit for formations and/or pools developed on 40-acre spacing within that vertical extent, which presently include the

Undesignated Flying "M" San Andres Pool.

(3) These units are to be dedicated to the applicant's proposed McGuffin "C" Well No. 1 to be drilled at a location considered standard for both oil spacing and proration units.

(4) The applicant is a working interest owner within the acreage comprising both units and therefore has the right to drill for and develop the minerals underlying both units.

(5) At this time, however, not all of the working interest owners in these units have agreed to pool their interests. After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners."

(6) No party affected by the forced pooling appeared at the hearing or objected to this application.

(7) To avoid the drilling of unnecessary wells, to protect correlative rights, to prevent waste and to afford to the owner of each interest in the units the opportunity to recover or receive without unnecessary expense its just and fair share of oil production in any pool resulting from this order, this application should be approved by pooling all uncommitted mineral interests, whatever they may be, within both units.

(8) Bettis, Boyle & Stovall should be designated the operator of the subject well and units.

(9) Any non-consenting working interest owner should be afforded the opportunity to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production.

(10) Any non-consenting working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

(11) Any non-consenting interest owner should be afforded the opportunity to object to the actual well costs, but actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(12) Following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of estimated costs should pay to the operator

any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(13) Reasonable charges for supervision (combined fixed rates) should be fixed at $5,000.00 per month while drilling and $500.00 per month while producing, provided that this rate should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*" The operator should be authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(14) All proceeds from production from the well that are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(15) If the operator of the pooled units fails to commence drilling the well to which the units are dedicated on or before August 1, 2001, or if all the parties to this forced pooling reach voluntary agreement subsequent to entry of this order, this order should become of no effect.

(16) The operator may request from the Division Director an extension of the August 1, 2001 deadline for good cause.

(17) The operator of the well and units should notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Bettis, Boyle & Stovall, all uncommitted mineral interests, whatever they may be, from the surface to the base of the Undesignated South Flying "M" Bough Pool underlying the following acreage in Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico, are hereby pooled in the following manner:

(a) Lots 3 and 4 (W/2 SW/4 equivalent) to form a standard 79.73-acre, more or less, stand-up oil spacing and proration unit for any pool within that vertical extent with special rules providing for development on 80-acre spacing, which presently includes only the

Undesignated South Flying "M" Bough Pool; and

(b) Lot 3 (NW/4 SW/4 equivalent) to form a standard 39.82-acre oil spacing and proration unit for formations and/or pools developed on 40-acre spacing within that vertical extent, which presently include the Undesignated Flying "M" San Andres Pool.

(2) These units are to be dedicated to the applicant's proposed McGuffin "C" Well No. 1 to be drilled at a location considered standard for both oil spacing and proration units.

PROVIDED HOWEVER THAT, the operator of the units shall commence drilling the well on or before August 1, 2001, and shall thereafter continue drilling the well with due diligence to a depth sufficient to test the Undesignated South Flying "M" Bough Pool.

PROVIDED FURTHER THAT, in the event the operator does not commence drilling the well on or before August 1, 2001, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

PROVIDED FURTHER THAT, should the well not be drilled to completion or abandoned within 120 days after commencement thereof, the operator shall appear before the Division Director and show cause why Ordering Paragraph (1) should not be rescinded.

(3) Bettis, Boyle & Stovall is hereby designated the operator of the subject well and units.

(4) After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners." After the effective date of this order and within 90 days prior to commencing the well, the operator shall furnish the Division and each known non-consenting working interest owner in the units an itemized schedule of estimated well costs.

(5) Within 30 days from the date the schedule of estimated well costs is furnished, any non-consenting working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(6) The operator shall furnish the Division and each known non-consenting working interest owner an itemized schedule of actual well costs within 90 days following

completion of the well. If no objection to the actual well costs is received by the Division and the Division has not objected within 45 days following receipt of the schedule, the actual well costs shall be the reasonable well costs; provided, however, that if there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(7) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of estimated costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator its share of the amount that estimated well costs exceed reasonable well costs.

(8) The operator is hereby authorized to withhold the following costs and charges from production:

(a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner who has not paid its share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished; and

(b) as a charge for the risk involved in drilling the well, 200 percent of the above costs.

(9) The operator shall distribute the costs and charges withheld from production to the parties who advanced the well costs.

(10) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $5,000.00 per month while drilling and $500.00 per month while producing, provided that this rate shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*." The operator is hereby authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(11) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8)-royalty interest for the purpose of allocating costs and charges under this order.

(12) Any well costs or charges that are to be paid out of production shall be

withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

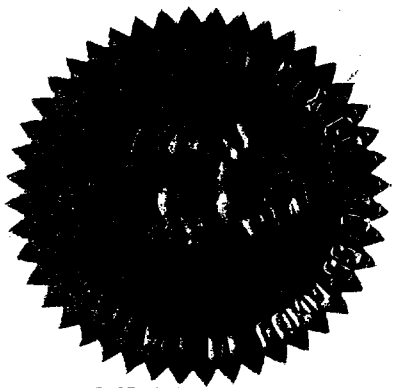
(13) All proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in Lea County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership. The operator shall notify the Division of the name and address of the escrow agent within 30 days from the date of first deposit with the escrow agent.

(14) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, that portion of this order authorizing compulsory pooling shall thereafter be of no further effect.

(15) The operator of the well and units shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(16) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Lori Wrotenbery

LORI WROTENBERY
Director

STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:	)	CASE NO. 12,601
APPLICATION OF BETTIS, BOYLE & STOVALL TO REOPEN CASE 12,601 AND AMEND ORDER NO. R-11,573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE PROPOSED WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO	)	

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

COMMISSION HEARING

BEFORE: LORI WROTENBERY, CHAIRMAN
JAMI BAILEY, COMMISSIONER
ROBERT LEE, COMMISSIONER

December 4th, 2001

Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Commission, LORI WROTENBERY, Chairman, on Tuesday, December 4th, 2001, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

I N D E X

December 4th, 2001
Commission Hearing
CASE NO. 12,601

* * *

A P P E A R A N C E S

FOR THE COMMISSION:

STEPHEN ROSS
Deputy General Counsel
Energy, Minerals and Natural Resources Department
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Santa Fe, New Mexico 87505

FOR BETTIS, BOYLE AND STOVALL:

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FOR SUN-WEST OIL AND GAS:

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P.O. Box 1216
Albuquerque, New Mexico 87103
By: STEPHEN D. INGRAM

* * *

WHEREUPON, the following proceedings were had at 9:00 a.m.:

CHAIRMAN WROTENBERY: We'll get started here. It's nine o'clock on December 4th, 2001, and this is a meeting of the Oil Conservation Commission. We're here in Porter Hall in Santa Fe, New Mexico.

I'm Lori Wrotenbery, and I am the Director of the Oil Conservation Division, and I serve as chair of the Oil Conservation Commission.

To my right is Commissioner Jami Bailey. She represents Land Commissioner Ray Powell on to the Commission.

And to my left is Commissioner Robert Lee.

We also have up here Florene Davidson, to my far right, who serves as the Commission secretary.

And then to Commissioner Lee's left is Steve Ross, the Commission's legal counsel.

And Steve Brenner will be recording these proceedings for us here today.

We've got several cases on the agenda. I think we'll skip over several of the preliminary matters and get right into the cases in the interest of time.

And we thought we'd take up Case 12,601 first. This is the application of Bettis, Boyle and Stovall to reopen Case 12,601 and amend Order Number R-11,573 to

address the appropriate royalty burdens on the proposed well for the purposes of the charge for risk involved in drilling said well. This is in Lea County, New Mexico.

We're hearing this case on the Application of Sun-West Oil and Gas, Inc., and it's being heard *de novo* under the provisions of Division Rule 1220.

This, Commissioners, is the case in the back of your books, I think, if you need that information, the very last one in your packet of materials.

And at this point we'll call for appearances.

MR. CARR: May it please the Examiner, my name is William F. Carr with the Santa Fe office of Holland and Hart, L.L.P. We represent Bettis, Boyle and Stovall in this matter.

MR. INGRAM: And Ms. Wrotenbery, my name is Steve Ingram from Stratton and Cavin in Albuquerque, and I'm here representing Sun-West Oil and Gas.

CHAIRMAN WROTENBERY: Anybody else? Okay.

Mr. Carr, would you like to get it started here?

MR. CARR: May it please the Commission, as we indicated in the prehearing statements that were filed in this matter, the parties have agreed not to present new witnesses today. The record in this case consists of the record made before the Division in April and May of this year, the exhibits offered at that time, and I believe a

post-hearing memorandum filed in the case on behalf of Sun-West Oil and Gas.

We are here today because when Bettis, Boyle and Stovall attempted to compulsory pool certain tracts of land in Lea County, New Mexico under the provisions of the Oil and Gas Act, another party, a party subject to pooling, Sun-West Oil and Gas, through a private contract, increased the burdens on their lease, they converted working interest to non-cost-bearing royalty interest. And we submit the purpose of this action was to avoid the provisions of the Oil and Gas Act to defeat the pooling application.

Now, in this case there is no issue as to the pooling of the subject spacing units, nor the 200-percent risk penalty that was imposed by the original order. What we are talking about is whether or not a party, through a private contract, can convert cost-bearing interest to non-cost-bearing interest once they are aware they are going to have their interest subject to a compulsory pooling action.

The facts in this case are fairly simple. Chronologically, they are these:

In December of 2000, Bettis, Boyle and Stovall wrote Sun-West Oil and Gas, the owner of a 15-percent undivided oil and gas interest in the west half of a section, and they solicited a lease from Sun-West.

Again in January of this year, Bettis, Boyle and

Stovall made a second offer. They offered an 18.75-percent royalty, and they advised Sun-West that a royalty rate above this level would make the drilling of the proposed well uneconomic.

The parties were unable to reach a voluntary agreement, and so on January 30th of 2001, Bettis, Boyle and Stovall filed its application for compulsory pooling. And on the date the application was filed, Sun-West was the owner of an unleased 15-percent mineral interest.

This application for compulsory pooling was received by Sun-West on February the 6th. And thereafter, on February the 15th, Sun-West leased these oil and gas interests to Gulf Coast Oil and Gas Company and reserved a 27.5-percent royalty. They had been advised that the well couldn't be drilled if it was increased above 18.75 percent. They conveyed it, or leased it, to Gulf Coast at a 27.5-percent royalty.

They thereby increased the share of the production from the Sun-West tract that would be paid to them cost-free in the event a compulsory pooling hearing or order was entered following hearing.

The hearing was on April the 19th, and the evidence in that hearing showed that Gulf Coast and Sun-West had the same address, they have the same telephone number, they have the same officers, and when you call Sun-

West or Gulf Coast, the same person will answer the telephone.

On April the 26th, the Division entered its order pooling the lands and imposing a 200-percent risk penalty, but that order was silent on Bettis, Boyle and Stovall's request that this royalty interest be disallowed and it be treated -- the property interest be treated as an unleased mineral interest would be treated, a one-eighth royalty and a seven-eighths working interest. But the order was silent on that.

And so on May 3rd of this year, we filed an application to re-open the case to address that particular issue, and the hearing was held on May 31st. At that time, no additional evidence was presented, there was -- Well, there was evidence, actually, from Bettis, Boyle and Stovall; there was none from Sun-West. But there were legal arguments from both parties.

And I think it's important to realize as you look at this, the only evidence in the record in this case is the evidence presented to the Division by Bettis, Boyle and Stovall.

On September 24th of this year, the Division entered its order, it granted the application of Bettis, Boyle and Stovall. And in that order it declared that the interest of Sun-West should be treated as it was on the day

the pooling application was filed, as an unleased mineral interest. Therefore, one eighth of it would be treated as a royalty interest, seven eighths as a working interest. And Sun-West appealed, and that's why we're here today.

This case presents, I believe, an important issue to the Oil Conservation Commission. We believe the issue is simply this: Can a party, through a private contract, take its interest, carve out non-cost-bearing burdens to avoid compulsory pooling, to improve their position, at the same time put at risk or defeat the statutory pooling authority of the Oil Conservation Division? We believe that is the issue that is before you.

I think it's important to briefly look at the Division's pooling authority. It's an exercise of the police power of the State, and you do this to conserve oil and gas and to ensure that minerals are developed. It isn't a taking, but what you do when you pool is, you qualify or you restrict the property interests to assure that they are, in fact, developed.

In our statute there are certain preconditions that must be met before you can get a pooling order. You've got to have, obviously, more than one interest owner in a spacing unit. One of them has to have a right to drill and proposes to drill.

And then the statute provides that parties have

been unable to reach voluntary agreement for development of the lands. This has been construed in the past to mean that the parties must engage in good-faith negotiations, and that those negotiations must be between the parties, not between a party wearing one hat and putting on another hat and, I submit, talking to themselves.

Here, there was no agreement between Sun-West and Bettis, Boyle and Stovall, and so Sun-West reached an agreement with Gulf Coast, happened to have the same owner, the same officers, same address, same employees. And what they did was, they passed the ball. They passed it, carved out a cost-free burden, carved it out, kept it and then passed the interest on to Sun-West, the individual, the company -- I mean to Bettis, Boyle and Stovall, the company that was going to take the risk and drill the well if they could afford to do it.

We submit that this is nothing more than undermining oil and gas regulation with a private contract.

And you know, this isn't an isolated case, because we believe that Sun-West was doing just exactly what its attorneys were telling it to do.

This is an excerpt from a paper that was presented to the Permian Basin Landmen's Association this year by Sealy Cavin, Mr. Ingram's law partner. And what it says, it says that -- It's an article on compulsory pooling

in New Mexico. And it says, "Since the participating parties generally bear the non-cost-bearing burdens, parties that anticipate compulsory pooling of their interests may want to consider carving out or conveying a non-cost-bearing burden prior to compulsory pooling. In this way, the parties being pooled can enhance their position."

What you have is a case which is a follow-up on this very statement. You have attorneys, you have parties, who are trying to enhance their position by changing the character of the property interest to improve their position in pooling and to put at risk the very authority of this agency when it attempts to force pool lands.

What does it mean, when you carve out a royalty interest? Well, it means two things: A larger percentage of your interest is free of cost; and it also means that there is a smaller interest against which the 200-percent risk penalty will apply. It means that the risk is being borne by the person drilling the well in a larger percentage, and that less risk falls on the person whose interest is being carried, the party who isn't taking the risk, the party who isn't paying for the well.

We ask you in this case to do what the Division has done in the past and say no to this kind of conduct, to say no to attorneys who advocate this type of effort to

subvert oil and gas regulation, to say no to Sun-West, to say that when you try to reach a voluntary agreement for the development of lands as you are required to do by statute, it means you talk with the other interest owners, you don't just cut a deal with yourself.

We think it's time for you to say that under the compulsory pooling statutes of this state, if someone has to carry your interest in the development of the oil and gas rights, you cannot get the benefit of that effort and at the same time, through a private contract, either with yourself or, I submit, with a stranger, prevent them from recovering the Division-authorized risk penalty, what they would have been entitled to had they not taken this unilateral action and in the process put at risk your order.

This is an important issue. It's an important issue to the parties in this case, but it also will set a very important precedent because I will tell you in my own practice I represent Yates Petroleum Corporation, and their affiliated companies, Abo, Myco, Yates Drilling, Agave, Nearburg Producing, Nearburg Exploration, McMillan Production Company, David Petroleum Company and these related entities, and if this is the way you want to go I think it's unlikely you'll ever see any of those people being pooled again.

We ask you to do what the Division did, not overturn the lease but restrict and qualify it, do what they did. They found that for the purpose of the pooling order this interest will be treated as it was on the day the Application was filed, as a one-eighth royalty and a seven-eighths working interest.

CHAIRMAN WROTENBERY: Thank you, Mr. Carr.

Mr. Ingram?

MR. INGRAM: May it please the Commission, I'm not going to go over the chronology. I don't think there's any need to. I think Mr. Carr has basically stated essentially what happened. We, of course, dispute -- and I'll get to that in a little bit -- the affiliate nature and the evidence underlying that between Sun-West and Gulf Coast, the parties to whom interests were conveyed after the pooling application was filed.

Sun-West, at the time the pooling application was filed in January, owned a 15-percent mineral interest. It did subsequently lease that interest or reserved unto itself a 27-1/2-percent royalty interest.

In its amended order, the Division took upon itself to declare the interest as being unleased for the purpose of the cost recovery and the risk penalty. It did so, as stated in the amended order, under the authority of its general authority and its pooling authority.

Sun-West is here to submit that the statutes upon which the amended order was based confer no such authority to essentially determine title to real property by retroactively declaring this royalty interest to not exist.

The first point, then, I'd like to go to is the statutory authority of the Division to do what it did. I think it's undisputed that the declaration of this interest doesn't exist, which is what happened here. It's not within the enumerated powers under Section 70-2-12. 70-2-17.C does allow the pooling of a royalty interest but doesn't allow the taking away of that royalty interest.

We are here to have a *de novo* hearing of the Division's amended order because we believe this order just goes too far. It goes beyond your pooling, and it does constitute a taking of the interest. This royalty interest has been declared to not exist. It does exist, it was conveyed at the time of the pooling application. Nonetheless, at the time the order was entered, at the time the proceedings were carried forth, this royalty interest was in existence. And by determining that this conveyance was of no effect, the Division in effect determined title to real property, something which we submit is beyond the jurisdiction and beyond the statutory authority of the Division to do.

Now, Bettis in its prehearing statement claims

that the OCD has the power to reduce the burdens imposed to circumvent its jurisdiction. We deny that this was done to circumvent the Division's jurisdiction. However, we also submit that the order exceeds both the explicit authority of the Division to protect the correlative rights of the parties and to prevent waste, and it exceeds the implicit powers attendant thereto.

This substantially reduced the royalty interest possessed by Sun-West, and it resulted in a complete taking of the Gulf Coast interest.

We're asking here that there be some standards in the Division's consideration of pooling applications, and we would submit that the effect of this amended order was an arbitrary one. It is very difficult for parties such as Sun-West to know how best to proceed, how best to protect their interests in light of this amended order.

Now, there's no reported New Mexico cases on point on this discrete issue. Bettis has claimed in its prehearing statement and its memorandum submitted to the Division that the prior OCD orders in the Nearburg and Caulkins matters did have the effect of reducing excessive royalty burdens. Those both can be fairly readily distinguished, and I think both on the basis of them being very extreme facts that are not present in this case.

In the Nearburg case, Merit had a working

interest and had reserved to itself a net profits interest.

Caulkins was a very extreme case where the override held by Meridian resulted in a negative daily return.

I should note that in that case the Division presented Meridian with two options. One, they could voluntarily reduce their override to 12 1/2 percent, or they could exclude their acreage from the unit.

Now, in this amended order the Division recited the availability of both of those options to Sun-West but only considered one, which was excluding them from the acreage, but because this was undivided interest in the whole unit, determined that that wasn't available and didn't consider the other option. It wasn't further addressed in the amended order.

Instead, the Division took the leap to declaring that interest to be unleased, and I think the effect is arbitrary and not considering other options and considering the availability of that to Sun-West in this case.

And in Nearburg and Caulkins I would also note that in neither case was the royalty interest just removed involuntarily in its entirety, as is the case here.

So my point with regard to this is that the two Nearburg and Caulkins cases cited by Mr. Carr in his briefing to the Division and to the Commission both present

very extreme cases that just simply aren't present in this case.

I'm jumping a little bit of myself, but Bruce Stubbs, the expert presented by Mr. Carr at the -- I believe the April hearing in this matter, did not testify that the effect of the royalty interest reserved to Sun-West would make this uneconomic. He said that in his opinion it would make it undesirable . We submit that that falls short of saying it's uneconomic and that it would frustrate the drilling of this well in this case.

Therefore, it's distinguishable again from the Caulkins situation. Mr. Stubbs did testify that even in the presence of this 27-1/2-percent royalty interest to Sun-West, there still would be a positive rate of return to be recovered.

Sun-West does submit in this case that this does constitute a taking. There is an interest that has been removed, has been taken away. The Division, by this order, said it doesn't exist for the purpose of this pooling Application. There were property rights that have been taken away from Sun-West and from gulf Coast.

Even if the police power of the State can be exercised to abrogate a private contract, we submit that it was not reasonably exercised here. It just went too far. It doesn't extend to declaring a vested property interest

to be a nullity. It can affect that property interest.

Again, we submit that it has gone to an extreme extent in this case, and it goes beyond the authority -- it goes beyond the statutory authority of the Division, it goes beyond the reasonable exercise of its police power to declare that this interest does not exist, to declare that this mineral interest is unleased. It is a deprivation of that property interest.

I don't believe that the -- Well, it appears that the retroactivity of this order is problematic. We submit the operative time frame is the time of the actual pooling, not the time of the filing of the pooling application. The pooling order is not effective until productive, yet this mineral interest is, according to the amended orders, being fixed on the date of the Application, and we submit that's inconsistent and doesn't support retroactivity of this order.

We don't believe there was substantial evidence for the finding by the Division that Sun-West and Gulf Coast are affiliates and therefore that this was not an arm's-length transaction, the leasing of this interest.

There's no regulatory presumption available to the Division in this case that I'm aware of as to an affiliate relationship based on a certain level of ownership. There certainly wasn't any evidence presented

by Bettis at the previous hearings of any common ownership between Sun-West and Gulf Coast. The testimony was, Mr. Maloney, a landman, heard from a friend of his in a telephone conversation that they had the same address and same phone number.

Absent further evidence than that, we submit that is wholly insufficient for the Division to then make a finding that these are affiliated parties, and therefore a contract between them was not an arm's-length contract. There's -- I believe it would be -- It would be reasonable to expect that there would be further evidence and more weighty evidence than that, to make such a finding that any contracts entered into between those two parties are not arm's length.

And again on a substantial evidence point, as I've mentioned before, we don't believe that there's substantial evidence to support a finding that this project was not economically viable in light of the royalty interest retained by Sun-West.

I think that's the basic points we have with regard to the amended order. Again, the issue as we see it is that this was not such an extreme case so as to warrant such an extreme finding by the Division that the interest should be declared unleased.

There is, based on -- there are -- Well, previous

cases that have dealt with this haven't gone as far as to declare unleased, and the facts on which those cases were based are very distinguishable from the one at hand.

Sun-West acted to protect its interests, it did not act to circumvent the Division's authority. We believe that the Division simply went too far in the remedy that it provided in its amended order and would respectfully ask the Commission to reconsider that and to reverse the amended order.

CHAIRMAN WROTENBERY: Thank you, Mr. Ingram.

Just for the record, let me clarify for all of us what it is that we have agreed to include as part of the record of this case. The transcript and the exhibits presented at the April 19th and May 31st hearings, we will treat those as evidence for purposes of this *de novo* proceeding --

MR. CARR: Correct, and Mr. --

CHAIRMAN WROTENBERY: -- correct?

MR. CARR: -- Ingram also indicated they had a post-hearing memorandum they filed after the May hearing that they would like to include. We have no objection to that.

CHAIRMAN WROTENBERY: Okay, so we will include that post-hearing memorandum as part of the record.

Do you have the date on that particular

memorandum?

MR. INGRAM: I believe it's June 13th, 2001.

CHAIRMAN WROTENBERY: Thank you.

Okay, so that along with the presentations you've made here today will be --

MR. CARR: Yes, and I have --

CHAIRMAN WROTENBERY: -- the record --

MR. CARR: -- just a couple of additional things I'd like to say in response to --

CHAIRMAN WROTENBERY: Okay, okay. Go ahead, then, please.

MR. CARR: Mr. Ingram has talked about the authority of the Oil Conservation Division and Oil Conservation Commission. And I think it's important to realize that in the Oil and Gas Act you're not just authorized to pool lands. It says when the statutory preconditions are met, you shall enter an order pooling those lands.

And then it talks about what is your authority to implement this statute? And the general authority says you, the Commission, shall have jurisdiction, authority and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of this Act or any other law of this State relating to the conservation of oil and gas.

You have very broad authority, and what you have done is certainly within that authority.

And compulsory pooling is simply not a taking. You can go back to early cases interpreting oil and gas conservation laws, you can go back to, I think, the landmark case, *Patterson vs. Stanolind Oil*. It's an Oklahoma case dating 1938. In that case it was concluded that it was an exercise of the police power, that it didn't amount or go as far as being a taking. That's where the language comes up that what you do is, you restrict and qualify property interest to enable you to carry out conservation statutes.

And so that's what you're doing. I don't know what you want to characterize an extreme case or not an extreme case. I think you have to look at those on the facts. But the facts here are, we in the negotiation process went to 18.75 percent, said we couldn't go more, and they quickly turned around and leased it to Gulf Coast for 27 1/2 percent.

And I don't know if they're exactly the same entity or not, I don't know if that makes any difference. If I take my interest because Ms. Wrotenbery is about to pool me and lease it to Ms. Bailey and put a royalty burden on it more than the parties trying to pool and Ms. Wrotenbery says she could bear, it sounds to me like that

might be an extreme case.

But I think you look at them on the facts, and you can take the Nearburg and the Caulkins case, and you can try and distinguish them on particular issues and particular remedies that were discussed, but the bottom line is, and the point of the cases, is that when individuals started with contracts to interfere with pooling authority, the Division said no.

And that's what we think you should do here. Because if you don't what you're saying is, it's all right for Sun-West to take the property and Bettis, Boyle and Stovall to take the risk. And I think that's not the purpose of the Conservation Act.

CHAIRMAN WROTENBERY: Thank you, Mr. Carr.

Anything else, Mr. Ingram?

MR. INGRAM: No.

CHAIRMAN WROTENBERY: Let me ask the Commissioners if they have any questions.

COMMISSIONER BAILEY: I do.

Has Sun-West drilled any wells in this area?

MR. INGRAM: Not to my knowledge.

COMMISSIONER BAILEY: Is Sun-West an operator in this area?

MR. INGRAM: I don't know that, Ms. Bailey.

COMMISSIONER BAILEY: Is Gulf-Coast an operator

my questions?

MR. INGRAM: Well, Ms. Bailey, I apologize. I'm here speaking more to the legal issues involved in this, and my preparation has been directed in that way, so I'm not going to be able to speak as much to the underlying facts involved in this. I think the record has been developed to the extent it has and has been presented to the Commission, and so I'm here speaking to the effect of the order primarily.

COMMISSIONER BAILEY: No point in asking any more questions, then.

CHAIRMAN WROTENBERY: Would you like to ask the parties to supplement the record with additional information?

COMMISSIONER BAILEY: Yes. Yes, I would.

CHAIRMAN WROTENBERY: Because I think we could do that.

MR. INGRAM: I would be happy to do so, Ms. Bailey.

CHAIRMAN WROTENBERY: So you might want to run down your list again, if you wouldn't mind, to make sure that we've got a clear idea of what additional information --

COMMISSIONER BAILEY: I'd like to know the relationship between Sun-West and Gulf Coast. I'd like to

know if Sun-West or Gulf Coast have drilled any wells in the area or are operators in the area. I would like to know what the standard is for royalty interests and what other royalty rates they have within their own company that they have charged and received. That should do it.

MR. INGRAM: I would be happy to provide that.

COMMISSIONER BAILEY: Thank you.

CHAIRMAN WROTENBERY: Steve Lee [*sic*], do you have recommendations on how we should proceed? I would suggest that maybe Sun-West submit that information in the form of a letter with a copy to Bettis, Boyle and Stovall, and Bettis, Boyle and Stovall would have an opportunity to respond.

MR. CARR: We'd like to do it quickly. We're sitting at the rig, we keep bumping back and bumping back and could drill during the first quarter next year, so we'll be ready to quickly respond.

CHAIRMAN WROTENBERY: Okay. Do you think you could get that information in by the end of the week?

MR. INGRAM: Sure, we can do that, Ms. Wrotenbery.

CHAIRMAN WROTENBERY: Thank you.

MR. ROSS: You know, I might suggest that anything that ends up in the record at least be submitted over an affidavit or something. To the extent we rely on

it, we need to have some form of admissible evidence in the record, sort of continuing this matter for further evidentiary proceedings in January, and that's the only thing I can think of to solve that problem.

MR. INGRAM: So it's a suggestion that we submit by affidavit the information requested by Ms. Bailey?

MR. ROSS: Do you see any problem with that?

MR. INGRAM: We can do that. Could we maybe have until Monday, then, to do that, just make sure, because our person is not local, just for transmission of --

CHAIRMAN WROTENBERY: That would be fine.

MR. INGRAM: -- papers?

CHAIRMAN WROTENBERY: So Monday -- that would be December 10th, I think it is -- we'll look for that additional information.

COMMISSIONER BAILEY: Were any of those questions addressed in the Examiner Hearing that --

MR. INGRAM: Yes, some of them were. There was -- Ms. Bailey, there was testimony by Mr. Maloney as to what information he had on the relationship, and there was information provided by Mr. Cavin, I believe in his arguments, at the conclusion of the May hearing, that did deal with some of those issues.

CHAIRMAN WROTENBERY: Commissioner Lee?

COMMISSIONER LEE: (Shakes head)

CHAIRMAN WROTENBERY: Steve, would you like to --

MR. ROSS: (Shakes head)

CHAIRMAN WROTENBERY: No? Okay.

Thank you very much, then. We'll look for the additional information next Monday and take this case under advisement.

MR. CARR: Thank you.

CHAIRMAN WROTENBERY: Thank you.

(Thereupon, these proceedings were concluded at 9:38 a.m.)

* * *

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Commission was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL December 8th, 2001.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002

STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION COMMISSION

CASE NO. 12,601

AWAITING FINAL COMMISSION ACTION

NO EVIDENCE OR TESTIMONY TAKEN

REPORTER'S TRANSCRIPT OF PROCEEDINGS

COMMISSION HEARING

BEFORE: LORI WROTENBERY, CHAIRMAN
JAMI BAILEY, COMMISSIONER
ROBERT LEE, COMMISSIONER

ORIGINAL

February 15th, 2002

Santa Fe, New Mexico

These matters came on for hearing before the Oil Conservation Commission, LORI WROTENBERY, Chairman, on Friday, February 15th, 2002, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

I N D E X

October 16th, 2002
Commission Hearing
CASE NO. 12,601
(Awaiting final Commission Action -
No evidence or testimony taken)

* * *

A P P E A R A N C E S

FOR THE COMMISSION:

STEPHEN ROSS
Deputy General Counsel
Energy, Minerals and Natural Resources Department
2040 South Pacheco
Santa Fe, New Mexico 87505

* * *

WHEREUPON, the following proceedings were had at 9:42 a.m.:

CHAIRMAN WROTENBERY: We do have one action we need to take, and that is in Case 12,601. This is the Application of Bettis, Boyle and Stovall to reopen compulsory pooling Order Number R-11,573 to address the appropriate royalty burdens on the well for the purposes of the charge for risk involved in drilling said well in Lea County, New Mexico.

We do have a draft order of the Commission in this case. It's Order Number R-11,573-B.

And Commissioners, I believe you've had a chance to review the draft order?

COMMISSIONER BAILEY: Yes, I have, and I intend to sign it.

CHAIRMAN WROTENBERY: And I'll entertain a motion that we approve this Order as drafted?

COMMISSIONER BAILEY: I so move.

COMMISSIONER LEE: Second.

CHAIRMAN WROTENBERY: All in favor say aye.

COMMISSIONER BAILEY: Aye.

COMMISSIONER LEE: Aye.

CHAIRMAN WROTENBERY: Okay, got it here. Do I have a -- Oh, here it is, signature page. I found the original.

That order is signed.

And I believe that concludes our business for today.

Florene, do we have anything else that we need to take up?

MS. DAVIDSON: No, not that I know of.

CHAIRMAN WROTENBERY: Okay, do we have a motion to adjourn?

COMMISSIONER BAILEY: I move we adjourn.

CHAIRMAN WROTENBERY: And do you second it?

COMMISSIONER LEE: Second.

CHAIRMAN WROTENBERY: Okay, all in favor say aye.

COMMISSIONER BAILEY: Aye.

COMMISSIONER LEE: Aye.

CHAIRMAN WROTENBERY: Thank you very much.

(Thereupon, these proceedings were concluded at 9:44 a.m.)

* * *

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STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Commission was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL February 18th, 2002.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002

STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION COMMISSION

CASE NOS. 12,459 and 12,601 (Continued)

CONTINUED CASES

TRANSCRIPT OF PROCEEDINGS

BEFORE: LORI WROTENBERY, CHAIRMAN
JAMI BAILEY, COMMISSIONER
ROBERT LEE, COMMISSIONER

April 26th, 2002

Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Commission, LORI WROTENBERY, Chairman, on Friday, April 26th, 2002, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

I N D E X

April 26th, 2002
Commission Hearing
CASE NOS. 12,459 and 12,601 (Continued)

* * *

A P P E A R A N C E S

FOR THE COMMISSION:

STEPHEN ROSS
Deputy General Counsel
Energy, Minerals and Natural Resources Department
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

* * *

WHEREUPON, the following proceedings were had at 10:10 a.m.:

CHAIRMAN WROTENBERY: Okay, and had also Case 12,459 on the docket for today. This is the Application of the Oil Conservation Division for an order requiring IT Properties to properly plug one well in Eddy County, New Mexico. This case will be continued to May 24th, 2002.

Commissioners, you may recall we've had this case on the agenda for a number of months here. I did touch base with the attorneys for the parties in this proceeding and have let them know that we will hear this case and are meeting in May if they have not resolved the matter by that time.

* * *

CHAIRMAN WROTENBERY: And I think we also had Case 12,601 listed on our agenda, the Application of Bettis, Boyle and Stovall to re-open Case 12,601 and amend Order Number R-11,573, to address the appropriate royalty burdens on the proposed well for purposes of the charge for risk involved in drilling said well, in Lea County, New Mexico.

What is the status of that case?

MR. ROSS: Well, Commissioners, Sunwest Oil and Gas has appealed your Order in that case to the District

Court. We put it on the agenda because it appears now, subsequent to the appeal being filed, that Bettis, Boyle and Stovall are not going to drill the well.

The order expires on its terms if a well isn't drilled in mid-May, and actually before we have to take any action on the appeal.

The parties were initially talking to me early in this week about having us dismiss that case, and that's why it was on the agenda. But they've subsequently decided they'll just let the order expire on its terms and then dismiss the appeal subsequently. So it actually doesn't need to be on the agenda, but that's why it was there.

CHAIRMAN WROTENBERY: Okay, thank you.

* * *

CHAIRMAN WROTENBERY: And we still need to take up the minutes of the March 26th, 2002, meeting. There is a draft of the minutes in our notebooks, and have you had a chance to look these over, Commissioners?

COMMISSIONER BAILEY: Yes, I have.

CHAIRMAN WROTENBERY: I'll entertain a motion for approval.

COMMISSIONER BAILEY: I so move.

COMMISSIONER LEE: Second.

CHAIRMAN WROTENBERY: All in favor say aye.

COMMISSIONER BAILEY: Aye.

COMMISSIONER LEE: Aye.

CHAIRMAN WROTENBERY: Aye. And I've got a copy here which I'll sign on behalf of the Commission.

Okay, is there anything else we need to take up today?

I don't hear anything, so this meeting is adjourned. Thank you very much.

(Thereupon, these proceedings were concluded at 10:14 a.m.)

* * *

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Commission was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL April 6th, 2002.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002

STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:	CASE NO. 12,601
APPLICATION OF BETTIS, BOYLE AND STOVALL FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO	ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

April 19th, 2001

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, April 19th, 2001, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

I N D E X

April 19th, 2001
Examiner Hearing
CASE NO. 12,601

* * *

E X H I B I T S

Applicant's	Identified	Admitted
Exhibit 1	7	19
Exhibit 2	8	19
Exhibit 3	13	19
Exhibit 4	14	19
Exhibit 5	16	19
Exhibit 6	19	19
Exhibit 7	26	33
Exhibit 8	27	33
Exhibit 1	27	33
Exhibit 2-A	28	33
Exhibit 2-B	28	33
Exhibit 2-C	28	33
Exhibit 2-D	28	33
Exhibit 2-E	28	33
Exhibit 3	28	33
Exhibit 4-A	29	33
Exhibit 4-B	30	33
Exhibit 5	-	33
Exhibit 6	30	33
Exhibit 7	30	33
Exhibit 8-A	-	33
Exhibit 8-B	31	33
Exhibit 8-C	-	33
Exhibit 9-A	-	33
Exhibit 9-B	32	33
Exhibit 9-C	-	33
Exhibit 10	-	33

* * *

A P P E A R A N C E S

FOR THE APPLICANT:

HOLLAND & HART, L.L.P., and CAMPBELL & CARR
110 N. Guadalupe, Suite 1
P.O. Box 2208
Santa Fe, New Mexico 87504-2208
By: MICHAEL H. FELDEWERT

* * *

WHEREUPON, the following proceedings were had at 9:07 a.m.:

EXAMINER STOGNER: At this time I'll call Case Number 12,601, which is the Application of Bettis, Boyle and Stovall for compulsory pooling, Lea County, New Mexico.

Call for appearances.

MR. FELDEWERT: May it please the Examiner, Michael Feldewert with the Santa Fe office of Holland and Hart and Campbell and Carr, for the Applicant in this case. I have two witnesses today.

EXAMINER STOGNER: Any other appearances? Will the witnesses please stand to be sworn?

(Thereupon, the witnesses were sworn.)

EXAMINER STOGNER: Mr. Feldewert?

C. MARK MALONEY,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. FELDEWERT:

Q. Mr. Maloney, could you please state your full name and address for the record?

A. Yes, sir, my name is Mark Maloney. I live in Roswell, New Mexico.

Q. And by whom are you employed and in what capacity?

A. I am self-employed, independent landman. I have numerous clients but have always been self-employed.

Q. And have you been hired by Bettis in this case?

A. Yes.

Q. And have you previously testified before this Division and had your credentials as an expert accepted and made a matter of record?

A. No, I have not.

Q. Would you please, then, summarize for the Examiner your educational background?

A. I have a degree from the University of Texas at Austin. Work experience?

Q. Are you a member of any organization?

A. New Mexico Landmans Association, since 1987.

Q. Okay, and when did you receive your degree?

A. 1975.

Q. And why don't you, then, summarize your work experience for the Examiner, please?

A. Again, I've been self-employed, independent, for approximately 25 years, numerous oil and gas states but specifically in southeast New Mexico since the early 1980s. I moved to Roswell in 1987 with Hondo Oil and Gas Association, Mr. Anderson, acquiring a number of properties from ARCO, and have been there more or less only in southeast New Mexico properties since then.

Q. And you said that was approximately for what? The last 20 years?

A. Yeah, Midland since the early 1980s, working primarily in southeast New Mexico and west Texas.

Q. And are you familiar with the Application that has been filed by Bettis, Boyle and Stovall in this case?

A. Yes.

Q. And are you familiar with the status of the lands that is the subject of that Application?

A. Absolutely.

MR. FELDEWERT: Mr. Examiner, I would tender Mr. Maloney as an expert witness in petroleum land matters.

EXAMINER STOGNER: Mr. Maloney is so qualified.

Q. (By Mr. Feldewert) Mr. Maloney, would you please briefly state what Bettis, Boyle and Stovall seek with this Application?

A. Yes, we'd like an order pooling all of the minerals from the surface to the base of the Bough "C". Primarily our location is in Lot 3, which is northwest-southwest equivalent, Section 30 in 9-33. Also, however, if there should be an 80-acre spacing, have Lots 3 and 4, west half, southwest quarter, dedicated to that well.

The primary objective is the Bough "C", however it is possible there is some San Andres production in there, which I believe are on 80-acre spacing, in the

Flying "M" San Andres.

Q. And do you seek a pooling order for 40-acre spacing?

A. Yes, we do.

Q. And what pool is involved with your 40-acre spacing?

A. That is the South Flying "M" Bough Pool.

Q. And which well are these spacing units to be dedicated to?

A. To the McGuffin -- Bettis, Boyle and Stovall McGuffin "C" Number 1 well, which will be located in the Lot 3, again northwest-southwest quarter equivalent.

Q. Is it to be a standard location?

A. Yes, it is.

Q. Okay. What is the status of the acreage in the west half of the southwest quarter of Section 30?

A. It is all fee, the entire west half of Section 30 is fee.

Q. Okay, why don't you identify for the Examiner and review Bettis Exhibit Number 1?

A. All right. Exhibit Number 1, Mr. Examiner, is our land plat of this area. The yellow outline is our leased fee acreage. The spacing unit for the proposed well is that cross-hached in red, again Lot 3.

Q. And would you identify, then, for the Examiner,

Bettis Exhibit Number 2?

A. Exhibit Number 2 is the uncommitted acreage breakdown for this west half acreage, and again the west half is common ownership. Sun-West Oil and Gas, Inc., owns an undivided 3/20, 15 percent; and two individuals, one Larry Kent Kirby, owns 1/320 mineral interest in here, and Thomas Wiley Neal, III, Trustee of the Thomas Wiley Neal Revocable Trust, owns undivided 1/80 mineral interest in there. The last two we've been unable to locate.

Q. These are the uncommitted, so there's roughly what, 83 percent that are committed to this project?

A. That's correct.

Q. Okay. So there's only three interest owners who are subject to this pooling Application; is that right?

A. Yes, that is correct.

Q. And you've indicated that you were unable to contact Mr. Kirby and then the -- Thomas Wiley Neal, III, as Trustee; is that right?

A. Yes, it is.

Q. Would you please identify for the Examiner the efforts that you undertook to contact Mr. Kirby?

A. Yes, Mr. Kirby had not appeared in title before, in leasehold title, although his property has been leased a number of times through the years. I was aware through the title opinion that was rendered for the drilling of this

well that he had acquired this interest through heirship.

I contacted Dan Girand in Roswell, who was related to Mr. Kirby by marriage, his father, and Dan informed me that he thought he was in Arizona. They'd kind of lost track through the years.

I called, got a number for a Larry Kirby in the Tucson area, an address, and sent him an offer December the 15th, more or less contemporaneously with the rest of the mineral interest owners, with the exception of the surface owner who owns the surface and undivided one-half.

I got a call from Larry Kirby in Tucson informing me that he was not the same Larry Kirby that we had sent this to. Then he did inform me that he knew of another Larry Kirby who had been in the area who he thought might have died.

In approximately the middle of January, we went through another attempt here to -- through directory assistance, probate, court clerks, assessors' offices in the Tucson area, to see if there was any Larry Kent Kirby either alive with -- owning property in either Pima or Cochise Counties, or deceased in either of those, could not find them. Again, no listing in Arizona for a Larry Kent Kirby or nationwide search.

We did contact through our counsel, Calder Ezzell of the Hinkle firm, to see if there was another address in

the title that he had examined, and he gave me another address which again was in the Tucson area, and I sent a letter to that address, and it was returned as undeliverable, so --

Q. Did you do a nationwide search as well?

A. Yes, we did.

Q. Okay. Why don't you summarize for the Examiner your efforts to find Thomas Wiley Neal, III?

A. Mr. Neal had leased a couple of times since he had owned this property. I had an address for Mr. Neal, no phone number.

We gave, again, the same -- contemporaneously, approximately December 15th, December 16th, sent him an offer letter. His was not returned. We had a number of these that were returned from previous owners, addresses had changed, whatnot. Mr. Neal's was not returned. Again, I could not find a phone listing for him in Albuquerque or in statewide New Mexico.

I did, again, do a nationwide search for Thomas Wiley Neal. I found a Thomas W. Neal in Massachusetts which I spoke to, but again it was the wrong person.

We sent a certified letter to Mr. Neal. Again, I did not return -- I received the first one as unreturned. Sent a certified letter in the middle of January, and that one was not picked up. It was basically returned as

unclaimed by the Post Office.

Q. And I think -- Did you testify you couldn't find a telephone listing?

A. Yes, that's correct.

Q. Okay. Why don't you summarize, then, your efforts to obtain voluntary joinder of the remaining interest owner subject to this pooling Application, which is Sun-West Oil and Gas, Inc.?

A. All right. Again, in this instance, I did not have an address. They had not leased -- Sun-West had not leased under this tract in a number of previous go-arounds, but I had an address for them because I had leased them a couple of years before in Eddy County. I sent that offer to the previous address. That one was returned. They had changed their address since 1998. And I spoke with the secretary there, told here we were planning on drilling the wells and an offer was on the way. Changed the address again, sent them the same offer, different address.

Mr. Spear, who was now the vice president, Nelson Spear, had been actually the president when I leased them before, and Shane Spear is now the president. We kind of played phone tag there at the end of that week, 16th.

The 20th again -- The 23rd, we talked about our offer, our plans out there. And Mr. Spear informed me he needed more -- higher consideration, higher royalty. And I

told him this was a fairly wild area, it was not quite the same as some other areas that they had leased in, in Lea County, and again in Eddy, not a multi-pay situation, and we weren't real sure that we could justify the higher royalty, and especially not a higher bonus as well. Indicated that he might wish to join, and again he said no, he didn't think so.

He was going to visit with Nelson. This again was right before Christmas. I believe that was on a Saturday. He visited with Nelson over the Christmas holidays and got back with me on the 28th, said that they had discussed it and felt that they would lease, they would prefer to lease, but again they want to stick with their higher royalty and higher bonus. I explained to him I could go a higher bonus -- we had done so with Mrs. McGuffin -- but not the royalty.

In again about the middle of January, I sent him a second letter restating our position and asked that they respond because by now we had had a pretty good indication from the rest of the lessors, the mineral owners out there, who was going to be participating, who was going to be leasing, who we were going to be able to find. We did want to get the well drilled as soon as possible, explained that, and I had asked him to give me a response within 30 days.

I got a letter back the 25th from Mr. Spear, basically reiterating the same.

I contacted Mr. Carr's office subsequent to that time, and we filed the pooling Application the 30th, I believe it was, of January.

Q. Is Bettis Exhibit Number 3 -- does it contain the letters that you just discussed?

A. Yes, it does.

Q. Okay, and then you indicated that your pooling Application was filed, then, on January 30th; is that correct?

A. That's correct.

Q. In your opinion, did you make a good-faith effort to locate the individuals and obtain a voluntary joinder from Sun-West?

A. Yes.

Q. What did Sun-West do after it received notice of Bettis's pooling Application?

A. Well, again, I had asked them to give us a response, in my January 20th letter, within 30 days. They did get the Application, the pooling Application, subsequent to that, February the 1st or 2nd, somewhere in there.

On the -- Literally on the 30th day at the 11th hour, they faxed to Mr. Carr and a copy to me of a

purported oil and gas lease executed to a company called Gulf Coast Oil in Midland.

Q. Is that reflected in Bettis Exhibit Number 4?

A. Yes, I believe that is. And that lease, basically -- the initial one that they faxed a copy to Mr. Carr and to me was very hastily done. They had included only the proration unit, and again we had offered to lease all of their minerals in the west half. They included only the proration unit that we had filed for here. One year -- Again, it was a 27-1/2-percent royalty lease. They said they had leased it for -- I believe it was $100 an acre.

But they had omitted the section on the description, legal description; it said Lots 3 and 4, 9-33, but no section. I noticed that and I didn't figure it would be recorded. It certainly shouldn't have been recorded. But the next day they did send a corrected one on that.

Q. Okay, now this was received after the filing of your pooling Application and after they had received notice; is that correct?

A. Absolutely.

Q. And it carved out a 27-1/2-percent royalty for Sun-West; is that right?

A. That is correct.

Q. Is that the royalty percentage that you told them

was unacceptable to you?

A. Oh, yes, it was in excess of one that -- They had originally asked for 25, and we said we couldn't do that in this particular area, we didn't feel that was justified, and that increased it even over that.

Q. Did the receipt of this assignment cause Bettis to continue the hearing on its pooling Application?

A. It did.

Q. Okay, and during the period of continuance did you investigate the relationship between Sun-West as the lessor and Gulf Coast as the lessee?

A. We did.

Q. And what did you find out?

A. We strongly suspected that there was a relationship, that they may have been the same. Armstrong -- First I was told that by an individual who works for a company in Midland who I do a lot of work for. *Armstrong Oil Directory* showed the same addresses, officers in the companies, phone numbers, et cetera, in 1998. So again we felt that they might have been the same. However, we couldn't absolutely prove that at that point.

Q. So what did you then do?

A. We then sent them a letter, to Gulf Coast Oil and Gas, basically advising them that in case they were not aware of the Application for pooling, that we had asked for

this, went through our efforts with Sun-West, told them basically that we, you know, had asked them to join back in December, they advised us they did not want to, and again sent this to Gulf Coast Oil and Gas at the address on the lease.

Q. Is that Bettis Exhibit Number 5?

A. It is.

Q. Okay. And what happened after you sent this letter?

A. Basically, Mr. Spear called the next day after their receipt and said, In answer to your question we are the same, yes, and we understand.

However, in my letter I had asked them again, if they did want to join, we'd send them an AFE and operating agreement.

And he said, No, we don't need one, we're not interested, we've looked into this, it's just a little bit wild; if you have to pool us, go ahead, we understand, no hard feelings, we'll do business down the road somewhere else.

Q. So Mr. Spear is the same person who you spoke with when you were dealing with Sun-West?

A. That's correct.

Q. And he confirmed that the entities were the same and that this was done after the pooling Application was

filed; is that right?

A. That's correct too.

Q. Okay. In your opinion, is this a transaction that the Division should recognize for purposes -- the pooling Application that you have filed?

A. No, I believe that this was an attempt to completely circumvent the process. They were aware of the pooling Application, they were aware of the options. To lease to a related entity or to a spouse or something like that, to me, is an attempt just to get around it. It was not acceptable at 25 percent, it was not acceptable at 27 1/2 percent, and...

Q. What's the net effect of this transaction if it's recognized by the Division, as it relates to any nonconsent penalty approved by the Division?

A. Well, we had asked early on -- Again, I had explained to them we couldn't carry a 15-percent interest in this well with a -- 25 percent or carry them, period, but we certainly couldn't do it with the 27-1/2-percent royalty. It reduces the net revenue available to the working interest participants in the well.

Q. And what do you ask the Division to do?

A. Basically treat the interest of Sun-West Oil and Gas as unleased, as if this lease had not been entered into. And if it were an unleased mineral interest I

believe it would be a 12-1/2-percent royalty and with a risk penalty assessment against that after we recover our costs.

Q. Now, let me ask you, have you made an estimate of the overhead and administrative costs while drilling this well and also while producing it if it is successful?

A. Yes, we have.

Q. And what is that?

A. It's $5000 a month for a drilling well, $500 a month for producing.

Q. Is there a joint operating agreement for this property that has been signed by other interest owners in the well?

A. There is.

Q. And are these overhead rates set forth in that joint operating agreement?

A. Yes, they are.

Q. Do you recommend that these figures be incorporated into any order that results from this hearing?

A. Yes, we do.

Q. Are there COPAS guidelines that are attached to the JOA for this property?

A. Yes, sir.

Q. Does Bettis, Boyle and Stovall request that the overhead figures approved by the Division be subject to

adjustment in accordance with the COPAS guidelines attached to the JOA for this property?

A. Yes, we do.

Q. Is Bettis Exhibit Number 6 an affidavit which attached letters giving notice of this hearing?

A. Yes, it is.

Q. And is it missing the green return receipts only for the two individuals that you could not locate?

A. Yes.

Q. Does Bettis, Boyle and Stovall seek to be designated operator of the proposed well?

A. Yes, we do.

Q. Were Bettis Exhibits 1 through 6 prepared by you or compiled under your direction and supervision?

A. Yes, sir.

MR. FELDEWERT: Mr. Examiner, I would move the admission into evidence of Bettis Exhibits 1 through 6.

EXAMINER STOGNER: Exhibits 1 through 6 will be admitted into evidence at this time.

MR. FELDEWERT: And that concludes my examination of this witness.

EXAMINATION

BY EXAMINER STOGNER:

Q. Who is the royalty interest owner underlying the west half of the section?

A. Who is the royalty interest owner?

Q. Yes, sir.

A. There are a number of them. The two largest, Mr. Examiner, are the surface owner, an elderly lady named Margaret McGuffin who owns the surface and one-half minerals. New Mexico Baptist Foundation, Trustee for the New Mexico Children's Home, is the second largest. They own an undivided one-fourth. So between those two, it's 75 percent. The rest of it is pretty well split. Obviously Sun-West Oil and Gas has a considerable interest, though, 15 percent.

Q. Okay, now the Sun-West interest, is that cost-bearing working interest, or is some of that overriding --

A. No, it's --

Q. -- I mean royalty interest?

A. -- it's unleased mineral interest.

Q. Unleased mineral interest.

A. Yes, sir. That came in to them through heirship. There was a company by the name of Pattee Royalty Association, acquired this mineral interest way back in the 1940s, subject to considerable litigation then, during World War II, after. And Sun-West is a successor to a portion of that interest.

Q. As with the Neal and Kirby interest, that's both unleased royalty -- or royalty interest that can't be

found; is that correct?

A. That's correct.

Q. Okay. Your December 15th letter to Sun-West represents the first contact with them; is that correct?

A. Yes, sir.

Q. And you requested them to lease the whole west half?

A. Yes, sir.

Q. At what time did you approach them, since you couldn't lease them, to have them join with you in this prospect?

A. First time that was probably mentioned was the 20th of December, 20th or 23rd, in one of those conversations, Mr. Examiner.

Q. Well, was there anything written?

A. No, there was not.

Q. Nothing written. Why not? Wouldn't that be something you would follow up with as a prudent landman, or am I missing something?

A. No, they really again indicated that they really wanted to lease this at a higher royalty and increased bonus. I was still negotiating with other parties in there. But I don't think from the get-go, frankly, they ever considered joining, even though I told them there was going to be a well drilled, that it was in the cards.

Q. So you initially offered them a 3/16 royalty?

A. That's correct.

Q. And what about the royalty for everybody else? Is that 3/16 or 1/8?

A. It's the same, 3/16.

Q. Three-sixteenths?

A. Yes, sir.

Q. Okay. Now, Gulf Coast was not notified of the -- what you did not know, anything about Gulf Coast, whenever you sent out your notification of the hearing; is that correct?

A. That is correct.

Q. Okay. But you have determined that Gulf Coast is one and the same or a spinoff of Southwest Oil and Gas, Inc.? I'm still a little confused --

A. I think they're just --

Q. -- about the association.

A. I think they are two different entities owned by the same people, frankly.

Q. Okay. When did you -- You sent out notice on February 1st. On February 20th, why didn't you just go ahead and send them out notice of the hearing, since you continued it to today's date?

A. I think we probably discussed that. I really can't recall.

Q. I don't care if you discussed it, I'm talking about -- I need something in writing here that they might have been notified, because you were aware that -- even though it might be questionable, but you were aware that they had a lease, and I assume that lease is outstanding or is correct, isn't it?

A. They did own that mineral interest. They could have leased it.

Q. But isn't that your understanding, and that's why you contacted Gulf Coast by mail on March 22nd?

A. It was -- We basically asked them -- or stated that we were not sure, we assumed that they were aware of that, since the oil and gas lease that was supposedly entered into was entered into after the date that they had received the notice. We asked them if they were aware of it. We assumed that they were, but we weren't sure of that.

And that was, again, sent out. And they acknowledged that, yes, we know.

Q. Okay.

A. We did get notice, we're the same.

Q. Okay, the March 22nd letter, you mention in here about a hearing in here on April 19th, and that was certified mail, return receipt --

A. Yes, sir.

Q. -- is that correct?

A. That's correct.

Q. Okay. Now, is that return receipt included in today's affidavit?

MR. FELDEWERT: No, it is not, Mr. Examiner.

EXAMINER STOGNER: For the record, Mr. Feldewert, why don't you have that submitted --

MR. FELDEWERT: Certainly.

EXAMINER STOGNER: -- and we'll just attach that to Exhibit Number 5.

Q. (By Examiner Stogner) Do you remember what the date showed? Was that sent out on March 22nd or the 23rd or 24th?

A. I think it was sent on the 22nd, and if I'm not mistaken he called me even before I got the return receipt back to acknowledge that, yes, we've got it and in response to your letter.

Q. Okay, let's make that a part of Exhibit Number 5, because this appears to be adequate notice since it does specifically state the April 19th date, but to make sure, let's --

A. Certainly.

Q. -- attach it.

A. Certainly.

Q. Okay. Now, did I hear right, $5000 drilling,

$500 producing?

A. Yes, sir.

EXAMINER STOGNER: Okay, I don't believe I have any other questions of Mr. Maloney. You may be excused.

THE WITNESS: Thank you, Mr. Examiner.

EXAMINER STOGNER: Mr. Feldewert?

MR. FELDEWERT: We would then call Mr. Stubbs.

BRUCE A. STUBBS,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. FELDEWERT:

Q. Mr. Stubbs, could you please state your full name and address for the record?

A. My name is Bruce A. Stubbs, I'm from Roswell, New Mexico.

Q. And by whom are you employed and in what capacity?

A. I'm a consulting petroleum engineer and have been hired by Bettis, Boyle and Stovall to develop AFE and well plan and testify in this case.

Q. Have you previously testified before this Division as an engineer and had your credentials accepted and made a matter of record?

A. Yes I have, and yes they were.

Q. All right, and are you familiar with the Application filed in this case?

A. I am.

Q. And have you made a technical study of the area which is the subject of that Application?

A. Yes, I have.

Q. And are you prepared to share the results of your work with the Examiner?

A. Yes, I am.

MR. FELDEWERT: Are the witness's qualifications acceptable?

EXAMINER STOGNER: They are.

Q. (By Mr. Feldewert) Would you please tell the Examiner what the primary target is for Bettis, Boyle and Stovall's proposed well?

A. The primary target is the Bough "C" formation at approximately 9100 feet.

Q. Would you identify for the Examiner Bettis Exhibit Number 7?

A. That's the AFE that I prepared back in December for the drilling of this well.

Q. Would you review the dryhole costs and the completed costs?

A. The dryhole cost is $459,174, completed well cost is $767,192.

Q. Are these costs in line with what other operators in the area have charged for similar wells?

A. Yes, it is.

Q. Are you prepared to make a recommendation to the Examiner as to the risk penalty that should be assessed against the nonconsenting interest owners?

A. Yes, I am.

Q. And what is that recommendation?

A. I think it should be the maximum, 200 percent.

Q. And would you briefly set forth the reasons for your recommendation?

A. Well, this is a moderate- to high-risk well. It has the possibility of encountering no reservoir, it also has the possibility of encountering a reservoir but at some stage of depletion.

Q. Okay. And why don't you then identify for the Examiner and review for him Bettis Exhibit Number 8?

A. Exhibit Number 8 is the data that I've gathered and the assumptions that I've made and the results that I've determined on this prospect as far as what's gone on in the area and the economics for this particular well.

If I can, I'll just run through this real quick for the Examiner.

If you'd refer to Exhibit 1, it's just a land plat showing the west half of Section 30 and then all the

surrounding wells. It's in a fairly well developed area. The Flying "M" Field is off to the east, northeast, the Flying "M" South Bough Field is located to the north and the northwest.

Q. And just for the record, this is page Exhibit 1 of Bettis Exhibit Number 8; is that correct?

A. That's correct.

Q. Okay, go ahead.

A. If you turn the page to Exhibit 2-A of Exhibit 8, I did a production study of all the wells in the two townships surrounding this prospect to determine what zones are produced in the area.

The two primary zones are the San Andres, which is produced to the east of the west half of Section 30, and the Bough "C" formation that's produced to the north and northwest of the location. There's one inactive Bough "C" well that was drilled on the west half -- it's in the northeast of the northwest -- and that well has produced 214,000 barrels, and it's either plugged or inactive at this point.

Turning to the next pages, these are all the wells in those two townships, Exhibits 2-B through 2-E of Exhibit 8. That's just the data that those maps were based on.

If you turn to Exhibit 3 of Exhibit 8, these are

the -- kind of a blow-up of the area surrounding the west half of Section 30, showing the cumulative production from the San Andres wells and also wells that were either tested or dry holes.

There's a San Andres test two locations to the north of the proposed location that made 625 barrels of oil.

The location just east of it had a DST in the San Andres, recovered some sulfur water, no real show.

There's a dry hole that's southwest of the proposed location, and there's another show well two locations to the northwest that made 125 barrels of oil.

The real production from the Flying "M" San Andres Pool occurs to the east, and you can tell from the map that as you continue east the wells get better. They range anywhere from 156 barrels to over 68,000 barrels in the east half of Section 30.

So I really feel that there's a low probability of encountering commercial San Andres at this proposed location.

If you turn the page to Exhibit 4-A of Exhibit 8, these are the Bough "C" wells in the area. There's eight Bough "C" wells that are produced. Those are the solid black squares. These wells have averaged 145,000 barrels of oil and 225 million cubic feet per well, so they've made

in excess of 1.1 million barrels out of that pool.

The well that's labeled Number 15 in the northeast of the northwest of Section 30 has cum'd 214,000 barrels.

The well labeled 16 that's in the southwest of the northwest had a drill stem test in the Bough interval, but it was tight and recovered a little bit of sulfur water.

And the well located in the southwest of the northeast of 30, labeled Number 17, also had a drill stem test in the Bough "C" and didn't recover any real shows and had depleting shut-in pressure. So it's either limited or tight.

I believe it's Well Number 10, located in Section 25, had another drill stem test in the Bough "C". It had a show of oil and gas but it had depleting pressures, indicating that it's either limited or somewhat tight.

Exhibit 4-B of 8 is just a brief description of each well, how much it's cum'd and what the test results were.

You continue on to Exhibit 6 of 8. This is a structure that Mr. Probandt provided me on the structure on top of the Bough "C" formation. There's a small structural high located in the east half of Section 25.

Continue on to Exhibit Number 7, this is an

isopach map of the Bough "C", and you can see that there's a band of -- algal mound band that falls off to the north flanks of that small structure. Mr. Probandt's theory is that that band of porosity and permeability in that algal mound will extend around to the east side of that structure, to the proposed location.

In my analysis, I have determined or I have estimated that there's a 50-50 chance that that reservoir actually does that, so that's where a lot of the risk comes in. It's either there or it isn't. You are cut off from the existing field by one dry hole located one location north of the location, so it's got to thread itself between those two dry holes before it comes around to the proposed location.

I've run two cases, I was asked to run two cases back earlier this year, and this is the results of those two cases.

If you'll turn to Exhibit 8-B of 8, this is the case using 3/16 overriding royalty interest on $100 per acre, and the risk-weighted reserves that I would expect from this well is 72,000 barrels and 112 million cubic feet of gas. This provides -- If you look down in the lower left corner, this provides a 28.13-percent rate of return before taxes. After taxes it would be roughly a 20-percent rate of return, which is kind of the low end of acceptable

to most operators.

I also ran a second case, which is Exhibit 9-B of Exhibit 8. This is assuming a quarter royalty and $150 per acre. And what happens is, the higher royalty rate causes the economic limit to be reached a little bit quicker. So there's only 71,000 barrels of reserves, and before-tax rate of return is 19.18 percent. After-tax return would be less than 20, and it's not acceptable economics.

Q. If the Division recognizes the transaction between Sun-West and Gulf Coast for purposes of whatever nonconsent penalty it imposes, does that change the economics of the project for Bettis?

A. If they have a higher overriding royalty interest.

Q. Or royalty?

A. Higher royalty, yes, it does, it puts that segment of the prospect in unfavorable economics.

Q. Okay.

A. They'd have essentially the same economics; it would just be a smaller percentage.

Q. I think you said your rate of return, that most companies use, is 20 percent as kind of the cutoff point?

A. Yeah, 20 percent after tax, which means you have to have about a 30-percent before tax.

Q. All right. And I assume if this transaction is

not recognized as a sham transaction between Sun-West and Gulf Coast, that the rate of return dips even lower than what your estimate shows; is that correct?

A. Right.

Q. Okay. Do you believe there's a chance that you could drill a well at the proposed location that would not be a commercial success?

A. Yes, I do.

Q. But in your opinion, will the granting of this Application be in the best interests of conservation, the prevention of waste and the protection of correlative rights?

A. Yes, it will.

Q. Were Bettis Exhibits 7 and 8 prepared by you or compiled under your supervision and direction?

A. Yes, they were.

MR. FELDEWERT: Mr. Examiner, I would move admission into evidence of Bettis Exhibits Numbers 7 and 8.

EXAMINER STOGNER: Exhibits 7 and 8 will be admitted into evidence at this time.

And I have no questions of Mr. Stubbs.

You may be excused.

THE WITNESS: Thank you.

Is there anything further in Case 12,601?

MR. FELDEWERT: The only thing, Mr. Examiner, is,

I would just briefly make a statement, and that is, I think what we have here is an effort by Sun-West to completely circumvent the pooling statute here in New Mexico. It's clear that the evidence clearly demonstrates that Sun-West created this lease to Gulf-Coast only after it received Bettis's pooling Application.

The evidence also demonstrates that in essence these two companies are owned by the same entities, and the evidence would seem to demonstrate, then, that this is really a sham transaction, and I would submit its sole purpose was to circumvent the pooling statute here in New Mexico and force an increased royalty burden on Bettis, Boyle and Stovall, and in essence decrease the working interest revenue stream that would be subject to the nonconsent penalty as provided by statute.

We think that this kind of effort by a party who was subject to a pooling proceeding is completely improper.

We ask that the Division, then, ignore that transaction for purposes of the nonconsent penalty and in essence treat the interest that's now held by Gulf Coast as an unleased interest that would be subject to the statutory provisions and in essence then ask the Division to recognize title as it existed at the time that the pooling Application was filed.

EXAMINER STOGNER: Thank you, Mr. Feldewert.

MR. FELDEWERT: Thank you.

EXAMINER STOGNER: I will hold the record open pending your submittal of the return receipt to Gulf Coast.

If there's nothing further in this matter, then pending the receipt of that I will then take it under advisement.

MR. FELDEWERT: Thank you, Mr. Examiner.

(Thereupon, these proceedings were concluded at 9:55 a.m.)

* * *

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 12601 heard by me on 19 April 2001

, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Division was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL April 23rd, 2001.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002

STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:	)	CASE NO. 12,601
APPLICATION OF BETTIS, BOYLE AND STOVALL TO REOPEN CASE 12,601 AND AMEND ORDER NO. R-11,573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE PROPOSED WELL FOR PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO	)	ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

May 31st, 2001

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, May 31st, 2001, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

STEVEN T. BRENNER, CCR
(505) 989-9317

I N D E X

May 31st, 2001
Examiner Hearing
CASE NO. 12,601

* * *

E X H I B I T S

Applicant's	Identified	Admitted
Exhibit 1	8	16
Exhibit 2	9	16
Exhibit 3	10	16
Exhibit 4	15	16

* * *

A P P E A R A N C E S

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FOR THE APPLICANT:

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By: WILLIAM F. CARR

FOR SUN-WEST OIL AND GAS, INC:

STRATTON & CAVIN, P.A.
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P.O. Box 1216
Albuquerque, New Mexico 87103
By: SEALY H. CAVIN, JR.

ALSO PRESENT:

RICHARD EZEANYIM
NMOCD Chief Engineer

* * *

WHEREUPON, the following proceedings were had at 10:42 a.m.:

EXAMINER STOGNER: This hearing will come to order. At this time I'll call Reopened Case 12,601, which is the Application of Bettis, Boyle and Stovall to reopen Case 12,601 and amend Order Number R-11,573 to address the appropriate royalty burdens on the proposed well for purposes of the charge for risk involved in drilling said well, Lea County, New Mexico.

Order Number R-11,573 was a compulsory pooling order for a well, so at this time I'll call for appearances in this reopened case.

MR. CARR: May it please the Examiner, my name is William F. Carr with the Santa Fe office of Holland and Hart, L.L.P. We represent Bettis, Boyle and Stovall in this matter, and I have one witness.

EXAMINER STOGNER: Any other appearances?

MR. CAVIN: Mr. Examiner, my name is Sealy Cavin. I'm an attorney with Stratton and Cavin in Albuquerque, and we represent Sun-West Oil and Gas, Inc. And we have no witnesses.

EXAMINER STOGNER: Are there any other appearances?

Will the witness please stand to be sworn at this time? Why don't you come on up here?

(Thereupon, the witness was sworn.)

MR. CARR: Mr. Stogner, I have just a very brief statement.

EXAMINER STOGNER: Mr. Carr?

MR. CARR: Mr. Examiner, as you noted, this reopened case involves a compulsory pooling Application. By Order Number R-11,573, entered in Case 12,601 on April the 26th of this year, the Division entered an order granting an application of Bettis, Boyle and Stovall and pooling certain spacing units in Section 30, Township 9 South, Range 33 East. The order imposed a 200-percent risk penalty on those interest owners who didn't voluntarily participate in the well.

When the application was filed, certain interests were unleased mineral interests. After the application was filed and prior to the time the order was entered, one of the parties leased those interests, and with the lease created a 27-1/2-percent royalty burden on that tract.

We today are before you asking you to treat the property as it was when the application was filed, and to treat the property as if it were encumbered with a one-acre 12-1/2-percent royalty, not a 27-1/2-percent royalty.

I will call a land witness to review the land portion of the case, basically to lay out the chronology of what happened, and then I have a legal argument.

MR. CAVIN: I don't have any opening statement.

EXAMINER STOGNER: Mr. Cavin?

MR. CAVIN: I don't have one.

EXAMINER STOGNER: Oh, you don't. I'm sorry, I thought you said you had one.

Okay, let's see. Also for the record, Order Number R-11,573, that was issued on April the 26th. The hearing date on that was April 19th. It shows March 22nd, but that was --

MR. CARR: The hearing date was actually the 19th. And also in the order, Mr. Examiner, an 80-acre unit was pooled on a 40 acre unit, and I believe the names of the pools were reversed in that, so that also probably needs to be corrected.

EXAMINER STOGNER: So noted, Mr. Carr. Thank you for calling that drafting error to my attention.

Thank you. Mr. Carr?

MR. CARR: At this time, Mr. Stogner, we call Mark Maloney.

C. MARK MALONEY,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. CARR:

Q. Would you state your full name for the record,

please?

A. Yes, my name is Mark Maloney.

Q. Where do you reside?

A. I live in Roswell, New Mexico.

Q. By whom are you employed?

A. I'm an independent landman.

Q. And in this case what is your relationship with Bettis, Boyle and Stovall?

A. They are my client.

Q. Did you do the land work that was involved as a predicate to the compulsory pooling application that was the subject of the original hearing?

A. Yes, sir.

Q. Did you testify at the April 19th Examiner Hearing on the original pooling application?

A. Yes, I did.

Q. At the time of that testimony, were your credentials as an expert in petroleum land matters accepted and made a matter of record?

A. Yes, they were.

Q. Are you familiar with the Application which was filed to reopen the case and address this royalty issue?

A. Yes, sir.

Q. Have you prepared exhibits for presentation for today?

A. Yes, sir.

MR. CARR: Are the witness's qualifications acceptable?

EXAMINER STOGNER: Is there any objection?

MR. CAVIN: No.

EXAMINER STOGNER: So qualified.

Q. (By Mr. Carr) Mr. Maloney, would you briefly summarize what Bettis, Boyle and Stovall seeks with this Application?

A. Yes, sir, we are asking for an order reducing the royalty burden on Sun-West Oil and Gas lease to 12 1/2 percent, or 1/8, as opposed to the 27 1/2 percent that they have currently burdened the interest with.

Q. Let's go to what has been marked for identification as Exhibit Number 1. Would you identify and review this, please?

A. Yes, sir, that is the exhibit for our McGuffin prospect, the land plat which was the same exhibit that was previously introduced in the April 19th hearing. The yellow highlighting represents the leasehold in the west half of Section 30 that Bettis, Boyle and Stovall, et al., own. The crosshached area is our proposed well site for the McGuffin "C" Number 1 well, located in Lot 3 at a standard location.

Q. You've indicated a 40-acre tract around that

well?

A. Yes, sir.

Q. And that was pooled by the order entered following the April 19th hearing?

A. That's correct, for the rights from surface to the base of the Bough C formation.

Q. And that order also pooled Lots 3 and 4, or the west half of the southwest equivalent of this section; is that right?

A. That's right. The Bough C in here would be on a 40-acre, and the only other possibility for production, it appears, is the San Andres, which is fairly remote, but that's on an 80 in that area, the McGuffin -- Excuse me, the South Flying M, I believe. Yeah.

Q. Would you go to what has been marked as Bettis, Boyle and Stovall Exhibit Number 2 and identify this, please?

A. These were the interests that were pooled at our April 19th hearing that we sought to pool and have. Sun-West Oil and Gas, Inc., with the largest interest there, a 3/20 mineral interest, 15 percent; Larry Kent Kirby with a small interest of 1/320 or 1 acre, approximately; Thomas Wiley Neal, III, Trust, again with a very small interest, 1/80. Those were unlocatable owners.

Q. Mr. Maloney, these set forth the interests that

were subject to pooling in the original case; is that correct?

A. Yes, sir.

Q. And these are the interests as you understood them to be at the time the Application was filed?

A. That's correct.

Q. What has happened to the Sun-West Oil and Gas, Inc., interest since the time the original pooling application was filed?

A. They leased their interest to Gulf Coast Oil and Gas, Inc., approximately three weeks after we filed our application.

Q. Let's go to what has been marked as Bettis, Boyle and Stovall Exhibit Number 3. Would you identify this and review it for the Examiner?

A. Yes, sir, this is a chronology of the correspondence, et cetera, dealing with Sun-West, attempts to lease Sun-West or obtain joinder, beginning back in December, mid-December of 2000, through recent efforts on our part.

Again, our first offer was back in mid-December, a letter, followed up again, second letter, January 20th. We had had several phone calls, conversations, in between.

Q. Were these contacts for the purpose of attempting to lease the acreage and bring this tract voluntarily into

the well?

A. Yes, sir.

Q. And what was the issue in your negotiations with Sun-West Oil and Gas, Inc.?

A. Primarily it was the royalty. We had offered 3/16 royalty and they requested 25 percent and asked for an additional bonus higher than we were paying as well.

Q. Was a 25-percent royalty acceptable to Bettis, Boyle and Stovall?

A. No, sir, it was not.

Q. What were the plans of Bettis, Boyle and Stovall in terms of timing for the development of this acreage?

A. Well, we had hoped to get this well drilled in the first quarter of this year. But again, rigs were tight. We've had this matter come up, and we're still waiting. Location is built, but we have plans on drilling right away.

Q. When did you file your Application for compulsory pooling?

A. I believe that was filed January 30th.

Q. And was that Application provided to Sun-West in accordance with OCD rules and regulations?

A. Yes, sir, it was.

Q. And when was it provided to them?

A. February 6th was when they signed the notice.

Q. And what happened after that?

A. Again, I had asked for them to reconsider January 30th, asked for a 30-day -- excuse me, in my letter of January 20th had asked for 30 days within -- for another attempt here.

But we got notice February the 20th, I believe it was, they sent a letter to you and faxed a copy to me, that they had leased this to Gulf Coast Oil and Gas.

Q. Was that lease actually recorded?

A. It was not. The first time they sent it to us they left off the section in the legal description. They had, again, included the acreage only that we had asked for in our order, Lots 3 and 4, although they owned undivided mineral interest throughout the west half of Section 30.

I was confident that was the right acreage, but they again left off the full legal description.

They followed up the next day with a corrected copy. The lease was acknowledge, I believe, February the 15th, and then it was actually recorded in Lea County February the 21st.

Q. We've got two copies of a chronology in this exhibit behind those pages. Is that a copy of the oil and gas lease that was recorded in Lea County on February the 21st?

A. Yes, sir.

Q. What did you do after this? Did you contact Gulf Coast Oil and Gas Company?

A. Yes, sir, we did. In March of this year we sent a letter, not being sure that Gulf Coast and Sun-West were the same entity, but we sent a letter to Gulf Coast on March the 22nd, again asking them to -- basically explaining what we had done with Sun-West, where we were, and informing them of the force-pooling hearing.

And they contacted me the following day. Again, that letter was sent the 22nd.

And March 23rd, Mr. Spear, Shane Spear, who is the president of Sun-West Oil and Gas, called and said, Yeah, we're basically the same, same family ownership. I think there might be little slight difference in the stock, I don't know. But essentially they were the same entity.

Q. When you say the same entity, you mean Sun-West and Gulf Coast?

A. Yes, sir.

Q. Did you discuss with them the ability of Bettis, Boyle and Stovall to carry a 27-1/2-percent royalty interest --

A. Yes, sir, in my letter to them of March 22nd, which again that letter was previously submitted in our April 19th hearing, but I told them that we could not -- 25-percent royalty we couldn't carry, and we couldn't carry

15-percent working interest, that was not -- it was too risky.

Q. Are the letters that are referenced in this chronology letters that were introduced and admitted into evidence at the April 19th hearing on the pooling application in this case?

A. Yes, sir.

Q. What effort did you make after you discovered that Gulf Coast had leased this property, what effort did you make to determine exactly who they were?

A. Again, they had a Midland address, post office box address. I did not know at that time of the relationship between them.

I called a friend of mine with Mewbourne Oil Company who does a lot of dealings with people in Midland, and he looked it up in his directory and he called back and said, I think they're the same people. They showed up in *Armstrong* with exactly the same names, same post office box address, same phone numbers, same --

Q. When you say they showed up in *Armstrong Oil Directory*?

A. Yes, sir.

Q. And it was there that they had the same officers?

A. Yes, sir.

Q. Same address?

A. Yes, sir.

Q. Same telephone number?

A. Exactly.

Q. When you contacted Gulf Coast did you also at that time talk to Mr. Spear?

A. Yes, again my first contact with Gulf Coast was by letter, and then Mr. Spear contacted me by phone the following day.

Q. Is this the same individual with whom you had made contact when you were dealing with this in the name of Sun-West?

A. Yes, sir.

Q. Could you just tell us what impact a higher royalty interest will have on Bettis, Boyle and Stovall's efforts to drill the well?

A. Well, as we previously testified, this was and is a risky prospect, and we have said from the git-go that we needed as high a net revenue interest as we could, that a 25-percent, in the opinion of our engineer, who I believe in the exhibit that Mr. Stubbs previously entered into testimony was -- the risk factor was just too heavy with the 75 percent, that revenue interest on interest.

Q. Is Bettis, Boyle and Stovall Exhibit Number 4 an affidavit confirming that notice of today's hearing has been provided in accordance with OCD rules?

A. Yes, sir.

Q. And you have notified, as shown on Exhibit A, a number of individuals; is that correct?

A. That's correct.

Q. And who did you notify?

A. These were the parties that were not leased of record or joined at the date of our original application.

Q. And some of these individuals have committed to the well, have they not?

A. That is correct, sir.

Q. Were Bettis, Boyle and Stovall Exhibits 1 through 4 prepared by you or compiled at your direction?

A. Yes, sir, they were.

MR. CARR: Mr. Stogner, at this time we move the admission into evidence of Bettis, Boyle and Stovall Exhibits 1 through 4.

EXAMINER STOGNER: Exhibits -- I'm sorry, is there any objection?

MR. CAVIN: No, Mr. Examiner.

EXAMINER STOGNER: Exhibits 1 through 4 will be admitted into evidence at this time.

MR. CARR: And that concludes my direct examination of Mr. Maloney.

EXAMINER STOGNER: Thank you, Mr. Carr.

Mr. Cavin, your witness.

MR. CAVIN: Thank you, Mr. Examiner.

EXAMINATION

BY MR. CAVIN:

Q. Mr. Maloney, I wanted to ask you a few questions about the April 19th hearing. I believe you testified at that hearing?

A. Yes, sir.

Q. And did you review the transcript, have you reviewed the transcript of that hearing?

A. No, I have not.

Q. Okay, but you prepared some of the exhibits that were presented at that hearing?

A. Yes, sir.

Q. Okay. And do you remember what Bettis, Boyle and Stovall was asking for at that hearing?

A. Yes, sir, we were trying to, again, pool all of the uncommitted interests in the Lots 3 and 4 for the Bough C test.

Q. Okay, and specifically, Sun-West interest, do you remember what you were asking for at that hearing on April 19th?

A. That any interest owner either join or be pooled for the drilling of that well.

Q. Well, weren't you essentially asking for the same thing you're asking for today, that they be treated as

unleased interest owner?

A. (Nods)

Q. I'm sorry, you have to speak up.

A. Yes, sir.

Q. Okay. And has anything changed since that hearing date, any material fact that's changed, to your knowledge?

A. No, sir.

Q. Okay. Has Bettis' position changed in any way, in a material sense?

A. No, not that I know of.

Q. And you testified about this at that hearing, didn't you?

A. Yes, sir.

Q. Okay. Now, I was going to ask you about your efforts to lease the Sun-West interest. Do you feel like you made a good faith effort to obtain a voluntary agreement?

A. Yes, sir.

Q. Okay, and what did you offer them?

A. Our original offer was $50 an acre and a 3/16 for a three-year oil and gas lease. This same tract had been leased previously about four -- I believe it was four years ago, and that was kind of the going rate at that time. They did not lease at that time. A number of the other

ones had. But there were also some owners that appeared to be unlocatable.

Q. Okay.

A. I guess that's a word. We asked for a title opinion from the Hinkle firm in late November. As soon as we had the large mineral owner who owns the surface leased, we sent the offer. And again, we knew who everyone was, according to Calder Ezzell's opinion, at least. We then made those initial offer of $50 an acre.

Mrs. McGuffin, the larger mineral owner, had agreed to lease but only at $100 an acre. So I proposed the same thing to Mr. Spear and told him that since we had originally sent out of offers I could go with a higher bonus and treat everyone the same, but I could not go with the quarter royalty.

And he said, Well, you know, we'd like to lease but we need a quarter royalty and, again, more money. He wanted $150 an acre, as well as the higher royalty. And we said we can't do this.

Q. Okay, so did you ever offer any more than the 3/16 royalty?

A. No, sir.

Q. Okay, so the 3/16 was your first offer and your last offer; is that correct?

A. That's correct.

Q. Okay. Now, are you familiar with what other leases go for in this area?

A. Only from the -- This is fairly wild area in terms of Lea County. From, you know, past experience it did not appear that this would be $150-, $200-an-acre country. And again, my client here had been involved in the leasing, W.T. Probandt was also involved in the prior deal. He's the geologist who's -- this prospect. So we were fairly familiar with that.

Randy Richardson who was the old landman, I think you know very well in Roswell, represented Mrs. McGuffin in this, and we did our negotiations with her through Randy, and he said, Yes, this is -- you know, this -- more than fair.

Q. What was the going rate four years earlier?

A. Fifty --

Q. Okay, and --

A. -- fifty dollars an acre.

Q. I'm sorry, what royalty four years earlier?

A. Three-sixteenths as well.

Q. Okay, things had not changed in that four-year period, the best you know?

A. No.

Q. Okay.

A. There hadn't been any more discoveries or

anything like that.

Q. Now, you said it's a wild area. Are there other producing wells in this area?

A. There's some San Andres wells just to the north, Mr. Cavin, in Section 19, that I'm familiar with. I think that Mr. Stubbs in the April 19th hearing testified as to the other production in this area, but again I'm familiar with 19 because we've also tried to work trades up there in the past. It's pretty marginal San Andres production, it's quite a bit of water with it. It's expensive.

Q. Okay. Now, so you would consider 3/16 and $100 an acre as sort of your take-it-or-leave-it offer; would that be a fair characterization?

A. Yes, sir.

Q. Okay. Now, can you tell me what the net revenue interest is to the working interest owners as it now stands with a 27-1/2-percent royalty to Sun-West?

A. I have not done that calculation for the purpose of today's hearing, but we basically would have 83-point-some percent at that 81.25. And again, the royalty on the unleased interest of the Kirby and Neal was 87 1/2, leaving the Sun-West interest, depending on whether it's leased or unleased -- You'd have to factor that. If it was, you know, 87.5, then obviously we're going to have a higher NRI.

Q. Well, let me ask you, assuming it's a 27-1/2-percent royalty, would it be fair to say that the net revenue interest and the working interest owners would be in the range of 78 percent?

A. I think that is correct.

Q. Okay.

A. Yeah.

Q. All right. Now, when you went out and leased, did you just strictly do it off what people are paying or leasing land in that area for?

A. I think that was certainly a consideration, yes.

Q. Okay, so Mr. Stubbs' report, where he gets into 3/16 royalty versus a quarter royalty, that was -- I mean, you didn't base your leasing on his economics, did you?

A. No.

Q. Okay. Now, have you reviewed Mr. Stubbs' report?

A. Briefly, yes.

Q. Are you prepared to testify on the economics of this venture today?

A. That I would defer to the prior testimony of Mr. Stubbs, really --

Q. Okay.

A. -- yeah.

Q. Okay, but do you remember his testimony on the rate of return that he had ascribed to these various net

revenue interests?

A. Yes, somewhat. I have to qualify that.

Q. Okay.

A. If I had a copy of it here I could probably -- It seemed to me like, Mr. Cavin, that he testified that a 75-percent, he felt, was just too risky, and he had a risk factor associated with various scenarios, you know, geology, is this going to hit the pay, et cetera.

Q. Well, basically -- tell me if I'm wrong -- he basically took an average well calculation and then came up with a rate of return based on different net revenue scenarios?

A. Yes, sir.

Q. Okay. And on what he says is a quarter override -- and I believe he means a royalty interest probably --

A. Yes, sir.

Q. -- he indicated that the average well would return 20 percent. Is that consistent with your recollection?

A. I think that is correct.

Q. Okay. And that would be paying a $150 bonus. And here, you wouldn't be paying any bonus on this lease, would you?

A. On -- ?

Q. On the lease that Gulf Coast now has.

A. No.

Q. Okay. And the other case he described was a 3/16 override. Again, I assume that he's referring to royalty; would that be --

A. I think that you're correct there.

Q. Okay, and a $100 bonus. And the rate of return there is 30 percent, and again this is on an average well. Is that your recollection?

A. Again, I would have to look at it, but --

Q. Okay.

A. -- yes.

Q. And he didn't give any credit in any of his calculations for uphole pay or anything like that; is that correct?

A. Again, I believe you're right.

Q. Okay. And did he factor in the fact that Bettis would get a 200-percent penalty on the lease to Gulf Coast?

A. I honestly cannot recall that one.

Q. Okay. Now -- So just so I make absolutely sure, because there was a little bit of confusion in the Application as opposed to what we're discussing today, at least from my perspective, you're not asking for a reduction in the royalty, in essence, you're just asking that it all be treated as unleased?

A. Well, I don't know -- I think -- At the time the

application was filed, it was unleased.

Q. Okay, I'm sorry, I'm asking about this Application to reopen. I'm just trying to find out what you're asking for here. Are you asking that it be treated as unleased?

A. We're asking that the royalty interest of Sun-West Oil and Gas, Inc., be treated as 12-1/2-percent royalty --

Q. Okay.

A. -- as opposed to 27-1/2-percent.

Q. Okay, so you're not suggesting that you wouldn't recognize the Gulf Coast lease in terms of what Gulf Coast has? Do you see the difference?

A. Well, Gulf Coast -- as it stands right now, Gulf Coast has 100-percent working interest in a 15-percent mineral interest lease with a 27-1/2-percent royalty burden.

Q. Yes. But what I understood is, you were asking for the Division to treat this interest as being unleased.

A. I believe that is correct.

Q. Okay, in which case, are you trying to -- are you asking that the Division ignore the lease to Gulf Coast?

A. Yes.

Q. So that Gulf Coast wouldn't have any interest under what you're asking for?

A. I believe that -- well --

MR. CARR: May it please the Examiner, I believe he's being asked questions that really are the legal argument.

Our position -- I can state it -- is, we don't quarrel with who holds the lease. We believe that the sequence is such that it imposes an unreasonable burden on the tract, and what we're looking at is what the royalty burden is. We're not saying you can't lease your property to anyone. Our argument will, I think, clarify this. But we're saying that once you commence a pooling action you can't lease it to yourself and increase the burdens and add additional burdens that run in the face of what the OCD is trying to do. I'll explain that in the argument.

But our position was correctly stated by Mr. Maloney. We believe that the royalty burden should be 12 1/2 percent, not 27 1/2 percent, whether it's held in the name of Gulf Coast or Mr. Spear and his family or held in the name of Sun-West, Mr. Spear and his family.

EXAMINER STOGNER: Does that clarify, Mr. Cavin?

MR. CAVIN: Well, I think what I heard him say was that the Gulf Coast lease would be ignored. Is that -- You would still recognize that; is that what you're proposing?

MR. CARR: Correct.

MR. CAVIN: Okay, yes, sir, thank you.

Q. (By Mr. Cavin) Mr. Maloney, I was going to ask you some questions about the two entities, Sun-West and Gulf Coast. Can you remember exactly what Mr. Spear told you when he was describing the two entities and their relationship?

A. Only that they were both family companies. In the directory, as I recall, Nelson was the president and Shane was the vice president, and I had asked him because I had leased them before about -- It was my understanding Nelson was no longer president, Shane was now president, and he affirmed yes, that's the same in both companies.

Q. Okay. I'm sorry, Armstrong directory, what does that tell you? Does it tell you who the directors are and the officers are, or --

A. Generally, yes, the president and vice president, sometimes the secretary, their address, phone numbers.

Q. Okay. Does it tell you who the owners are?

A. Not necessarily.

Q. Okay. So you wouldn't dispute the fact that the ownership is different in these two entities? Do you have any basis to do that?

A. No, I do not. I have not checked further, in all honesty, on that.

Q. Okay, and it wouldn't tell you that anyway --

A. No.

Q. -- Armstrong wouldn't?

A. No.

Q. And your sources in Midland couldn't tell you that either, right?

A. No.

Q. Okay. Now, would it tell you that Gulf Coast is a Delaware corporation?

A. I don't recall, I really don't. I don't think so. I don't think it shows in the articles of incorporation or with the State. You'd have to check with the Secretary of State. As I recall, Sun-West was a Texas corporation. I can't recall, again, whether Gulf Coast showed as a Delaware or a Texas. I thought it was Texas.

Q. And how did you learn that Sun-West was a Texas corporation, I'm sorry?

A. On their acknowledgements.

Q. Okay. And you don't dispute that they're separate legal entities, do you?

A. Again, I don't really know exactly what --

Q. I mean, did you make any --

A. -- they're certainly --

Q. I'm sorry.

A. -- two different names.

Q. Did you make any inquiry to ascertain whether

they're separate legal entities?

A. No.

Q. Okay. So if I'm reading Mr. -- and I'm jumping around on you, I apologize. I'm about to finish up. If I'm reading Mr. Stubbs' report right, and we already covered this, a quarter royalty is a 20-percent rate of return on an average well, and the 3/16 royalty is a 28-percent rate of return, I think you would agree with me that the 78-percent net or thereabouts that you have would be somewhere between those two, rate of return?

A. I would agree with that.

Q. Okay. So basically we're probably looking at 24-something, roughly 24-percent rate of return?

A. That I can't tell you on the exact rate of return, I don't recall his -- But as I recall, the 25-percent, he felt, was uneconomical in today's market, with the prices what they were.

MR. CAVIN: Okay, I have no further questions.

EXAMINER STOGNER: Thank you, Mr. Cavin.

Any redirect?

MR. CARR: No redirect.

EXAMINER STOGNER: It's obvious in reopening we're going to take administrative of the previous case in this particular instance.

MR. CARR: Yes, sir.

EXAMINATION

BY EXAMINER STOGNER:

Q. Now I don't have the previous exhibits, but did you contact Gulf Coast originally, or was it just Sun-West?

A. Sun-West.

Q. So you didn't know anything about the Gulf Coast until after --

A. No, sir, it was --

Q. Well, it's --

A. I think it was February the 20th when they faxed us a copy of the letter, and they sent it to Mr. Carr, and sent a copy of it to me, Mr. Examiner. And again, that was the first I knew of them.

Q. Okay, that was the February 15th letter?

A. Yes, sir, they faxed us on the 20th.

EXAMINER STOGNER: There being no other questions of Mr. Baker at this time, I think we're ready for closing statements, legal argument.

MR. CARR: As the Applicant, I ordinarily would go last, but I am prepared to go anytime. Would you like me to argue?

EXAMINER STOGNER: Gentlemen, I'll let you decide.

MR. CAVIN: Go ahead if you want, Bill.

MR. CARR: I'm prepared to go forward. I may

have a response after Mr. Cavin argues.

I think we ought to put this in some context. This is a follow-up to a hearing, a reopened case. The case was originally presented on the 19th of April. It was a compulsory pooling case. And at that time notice of the application was provided to Sun-West. They did not appear.

The order was entered in the case, but it didn't address one of the questions raised, and that was, how do you treat an additional burden that is placed on a property subject to pooling after the Application was initially filed.

Today I've called a land witness who provided a chronology, and it is our belief that there is at least overlapping if not virtually identical ownership between Sun-West and Gulf Coast. They've both had notice. And although we've asked a land witness to speculate, we don't know. All we know is, they used the same address, they have the same telephone number, they have listed in a directory the same officers, and when you call either of them you talk to the same person on the phone. We assumed they were the same.

But that is not an issue that's going to be determinative of what we're trying to bring to you today. We're bringing to you an issue which we think is of importance. It's not completely new, and I'll get into

that in a minute. Similar questions have been heard before. But it is an issue that has a direct impact on this and other pooling orders because of the precedent you can set. It has a direct impact on your jurisdiction and your ability to carry out your authority under the Oil and Gas Act to pool properties.

And we are asking you to issue an amended order and treat the Sun-West/Gulf Coast interest as if it is burdened with a 1/8, 12-1/2-percent royalty, not a 27-1/2-percent royalty.

And the facts that you need to consider to address this issue are relatively simple. As required by the Oil and Gas, the parties negotiated with one another. The OCD doesn't tell them what is a good deal or what is a bad deal; every company's economics are different. But you require they attempt to reach an agreement. And they did, they attempted. No agreement was reached.

And the issue in those negotiations was, how much of a royalty burden could be placed on this interest and still have an economic prospect for Bettis, Boyle and Stovall. And they told Sun-West that 25 percent was too high.

And it reached a point where they were prepared to go forward with the well, it was set forth in the letters that are in the record of this case.

And when they couldn't reach an agreement they did what they're supposed to do, they filed an application seeking an order from this Division pooling those lands. They provided notice to Sun-West. Sun-West got the notice, 7th of February, 6th of February, one of those days, and signed a return receipt. It's in the record of the case.

And a week later, on the 15th, having not been able to reach a voluntary agreement to set a royalty rate, what did they do but they leased it to another company, Gulf Coast, same directors, same address, same phone number, same person to talk to on the phone, and they put a 15-percent additional burden on the property. And all of a sudden they come and say, Well, go ahead, pool us. But by the way, what we couldn't reach in terms of an agreement before you took it into the regulatory practice, we have done by private contract. We have 27-1/2-percent royalty burden.

We submit they contractually changed the game at that time, after we were before the regulatory body.

I think the question here is not whether or not Gulf Coast owns the working interest or Sun-West. We don't care. We'll pay whoever is the rightful owner of that interest.

But the question here, is this interest to be treated, for the purposes of the pooling order, as the

unleased mineral interest that it was when the application was filed, or as a leased interest burdened with a 27-1/2-percent royalty?

Now, we submit that unless you agree that this regulatory scheme we work in can be circumvented by a private contract, that you must treat the interest as an unleased mineral interest. And there is precedent for what we ask. And I have the orders and I'll provide copies to all of you here in a minute.

In a case, Number 8640 -- this is a 1985 case in which Caulkins Oil Company was here. They were concerned that a tract they were trying to pool had a royalty burden on it that was unreasonable and would affect their economic ability to drill the well. And the Oil Conservation Division pooled the lands and directed the parties to reduce the overriding royalty, because to do otherwise would be to enter a compulsory pooling order under terms that were not just and reasonable to the party who was drilling the well. And I have copies of that order.

In 1998, Order Number R-11,109, Nearburg Exploration Company was attempting to pool a tract. That tract had -- One of the parties being pooled was Merit Energy Company, and they had what the order says is an internal net profits interest, the details of which had not been disclosed to Nearburg, which might unnecessarily

burden Merit's working interest.

And what did the OCD do? Well, the OCD said that they were going to treat the full working interest, including the net profits interest, as being subject to the cost of drilling, the cost of completion and the penalty.

That's what we're asking you to do here today. We're saying we don't care what they do today or what they did at any time after our Application was filed. But the interests are fixed on that date, and your jurisdiction -- An operator can't go out and start playing games. If so, I guess I'd advise everyone I represent to form a sham company.

And if Mr. Cavin's clients are trying to pool you, well, after you get the pooling notice, pass it to yourself and carve out a big royalty or an override, or create a net profits interest. And do these things because the net effect is to take the burden off of you and put the burden on the guy who's going to bear the risk of developing the property, who's going to pay the cost, who's going to drill the well. And you said in the Nearburg case that that is something you cannot do.

And I submit that both of those -- one's a net-profits interest and one's an override, neither are royalty -- both of them are good precedent for the issue before you today.

In 1997 there was a case, Branko, Inc., et al. This is a case that was a complicated matter before the Division and the Commission on a number of occasions. The order in that case, the final order, is Order Number R-10,672-A.

This involved a pooling case. There were interests that were not of record. And at the time of the hearing, Branko's counsel came in and said, There are different parties you need to pool, although their interests aren't of record. Here they are. Mitchell Energy went ahead, stood on the pooling order and said they weren't of record on the day we filed. The day you file is the day that counts.

And the Oil Conservation Commission entered an order, and it concluded that they weren't entitled to notice. It finds in the conclusions of law that are on pages 8 and 9 of this order -- and I have copies of this -- basically it notes that under New Mexico law these are interests that must be recorded in the county, that they were not on the day the Application was filed, and as such these people were not entitled to notice.

We submit that that same theory applies here. The interest on the day our Application was filed was simply that we were dealing with an unleased mineral interest.

Now, what do you do with an unleased mineral interest? We have a pooling statute. It says where you've got more than one interest in a spacing unit, where one interest owner proposes to drill, has a right to drill and can't reach a voluntary agreement, it says then you bring an application here, and after notice and hearing, the statute says, the Division shall enter an order pooling said lands.

And we recite that over and over again to you, every week I come over here and recite. It's a very easy way to practice law, you only have to memorize one section of statute.

But it goes on beyond that, and it says, and I quote, "If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest, and he shall in all events be paid one-eighth of all production from the unit and creditable to his interest."

The statue says if we come before you and are pooling an unleased mineral owner, you treat it as 1/8-7/8. And we submit in this case we came before you and we sought to pool an unleased mineral interest, and that interest by statute should be divided 7/8-1/8, and that after the fact,

when faced with that, a party cannot be allowed to run out and enter a private contract to circumvent the regulatory process.

I tried to find a case on point, and I don't know if it's a reflection on me or the status of the law, but the case is a 1938 Oklahoma case, it's *Patterson vs. Stanolind Oil*, and it's 77 Pacific 2nd 83. But it's held that parties by private contract, agreement or assignment cannot circumvent or preclude the Corporation Commission -- the Oklahoma entity -- from exercising its jurisdiction and authority.

If you let parties start passing the ball around and carving out interest, I submit you're authorizing private contracts, agreements and assignments to run right straight in the face of your jurisdiction, and you cannot allow that to happen. The numbers will always be different, it may be a royalty, it may be an override, it may be a production payment, but the issue is always the same.

They're changing the game. They're trying to do -- by passing it back and forth among themselves or a friend or an arm's length transaction, they are still going to be changing the ownership and putting additional burden on the party who's going to take the risk, who's going to drill the well, and who's going to actually be going

forward developing the minerals of the State of New Mexico, and they're going to put additional burden on them in a way that is outside the Act.

Now, Texas doesn't have a compulsory pooling statute, and I would submit that there are many wells that might have been drilled in Texas, had they had such an act.

Whether, in fact, the final numbers sift out here in a way that means that this well won't be drilled, I can't say for sure. But I can say what's happened here after we filed our Application increased the burden and is making those who want to go forward rethink this issue.

If a well isn't drilled, I submit to you that's waste. And I submit, if you don't take your stand on this case, you're opening a door that will undercut your jurisdiction.

MR. BROOKS: What were the facts of that Oklahoma case, you say?

MR. CARR: Sir, it's an old, old decision. I'll be happy to give it to you.

MR. BROOKS: Okay, well, I'm sure we can get it, but --

MR. CARR: But it is --

MR. BROOKS: You --

MR. CARR: -- obviously even older than me.

MR. BROOKS: -- decide it as a proposition of law

in which --

MR. CARR: Yeah --

MR. BROOKS: -- the one side --

MR. CARR: -- right.

MR. BROOKS: -- a case of any age for a proposition of law, I'd kind of like to know if the law was applied on --

MR. CARR: I can --

MR. BROOKS: -- facts that were any way similar.

MR. CARR: Sure, and I can provide that to you along with the orders.

I have also, and I will admit after the hearing, with the orders, a memorandum and some proposed findings.

MR. BROOKS: Very good.

MR. CARR: And I will get that case for you.

MR. BROOKS: Thank you.

MR. CARR: I looked at it, but I was looking at it fast, I didn't -- and --

EXAMINER STOGNER: Or if you can -- It's in the *Oil and Gas Reporter*, isn't it?

MR. CARR: Well, it's -- Pacific site. I have it --

MR. BROOKS: It's too old to be in the *Oil and Gas Reporter* --

MR. CARR: It's in an old --

MR. BROOKS: -- if it's 1938.

MR. CARR: It's an old case --

MR. BROOKS: They didn't start the *Oil and Gas Reporter* until about 1951, I don't believe.

MR. CARR: I think that's right. It's a 1938 case, but we do have a copy --

MR. BROOKS: Okay, well --

MR. CARR: -- we'll get it to you.

MR. BROOKS: -- if you'll furnish us --

MR. CARR: -- I will --

MR. BROOKS: -- we'd appreciate it.

MR. CARR: Yes, sir.

EXAMINER STOGNER: Mr. Cavin?

MR. CAVIN: Yes, sir, Mr. Examiner.

First of all, your original order was obviously well thought out and carefully considered, and there was a great deal of discussion at the prior hearing on this very issue. So we certainly believe that the order may not have addressed it, but it in our view addressed by omission.

First of all I would say there was not a good faith effort to obtain voluntary agreement. They simply went out and found out what the biggest lease owner would lease for, and they used that as their standard, and they hammered that home to everyone. They didn't budge from that. And in my book that's not a good-faith effort to

reach voluntary agreement, and I think the record will show that in terms of the letters they sent and also the testimony today and at the 19th hearing.

We of course think that the Division should stay out of private contracts, and by interjecting themselves in this situation, we think you'd be getting right in the middle of it.

These are separate legal entities, one of them is a Delaware corporation. They've been set up for some time now. They're not sham entities. They've got different ownership. One of them is a Subchapter S Corporation, which is a pass-through entity, one of them is a Subchapter C Corporation. They serve different purposes, the ownership is different, and frankly they're separate legal entities, and we can't agree that this is a sham transaction.

We believe it would be a serious problem -- Well, we think there's a serious issue on the authority of the Division to reduce the royalty or treat this as unleased when, in fact, it's leased at the time you're entering the pooling order. And to the extent that the Division may have authority, it should only be used in extraordinary cases.

And clearly, this is an extraordinary case. By their own witness, the rate of return is somewhere between

20 and 30 percent on these wells, and that's if you take the average wells, if you don't factor in upside potential and if you don't factor in the 200-percent penalty that they're going to get on the lease to Gulf Coast.

I would also point out -- I certainly didn't come prepared to rebut all of the cases that Mr. Carr has cited. I would, however, speak to the Branko case, since we were unfortunate enough to be on the losing side of that case that went all the way up.

First of all, we think *Branko* is distinguishable in its facts, and we think it was wrongly decided, and it could be a problem for the Division.

Mr. Carr noted that *Branko* holds that if there isn't an instrument of record, that's the controlling event. And we think that is bad law. If the parties have actual notice, that's really the triggering event, in our view, both in courts and before regulatory forums, and certainly in the public records, actual -- where a pure notice state and actual notice is more important than constructive notice. So we would distinguish *Branko*.

So in summary we believe your prior order should be affirmed without modification.

EXAMINER STOGNER: Is there anything further?

MR. CARR: Very briefly. I would just note that there's no limit in the Oil and Gas Act on your

jurisdiction, no restriction that I can find in the Act that would preclude you from reducing or directing as to how a risk penalty should apply to the interests that are subject to one of your pooling orders. The pooling statute expressly says you're pooling all interests. It references royalty interest owners.

And so, one, you can pool them, and I think under the general powers of the statute you can determine to what interest the penalty will apply.

We're not here challenging the lease. They can lease it to Gulf Coast or to anyone they want. We're simply stating that when you ordered that a penalty will be imposed, you should have ordered that it will apply to their working interest, but that in so doing it will include any royalty interest that was carved out of that working interest after the date the Application was filed.

EXAMINER STOGNER: Anything further?

MR. CAVIN: Well, I would just simply note, we think there are serious due-process considerations, and there would be really a taking here. And so there may be authority in extraordinary circumstances, but we certainly don't see it here.

EXAMINER STOGNER: What would be a sufficient amount of time to get the written comments in, gentlemen?

MR. CARR: I'll be happy to file mine today,

they're ready to be filed. And then whatever Mr. Cavin needs to respond would be fine with me.

MR. CAVIN: Okay, maybe a week, if that would be acceptable?

EXAMINER STOGNER: A week, that would be fine.

MR. CAVIN: Mr. Examiner, I'm sorry, I'm going to be in Alaska next week, I apologize. I'm leaving Saturday. Just skipped my mind.

EXAMINER STOGNER: I assume you're asking for a little bit --

MR. CAVIN: Well, I realized as I said that, that I'm thinking a week ahead, and I'm really thinking two weeks ahead. I'm going to be out of the office starting Saturday. So with permission I'd like two weeks.

EXAMINER STOGNER: Two weeks.

MR. CARR: If he had a work matter that was bogging him down, I wouldn't object, but... I have no objection.

EXAMINER STOGNER: Two weeks is not an unreasonable amount of time.

MR. CAVIN: Thank you.

EXAMINER STOGNER: So we'll accept your written comments at this time, and you have a copy prepared for Mr. Cavin.

Mr. Brooks, is there anything further?

MR. BROOKS: No, I -- satisfied, await the written comments.

EXAMINER STOGNER: With that, since there's nothing further in Reopened Case 12,601, hold the record open for two weeks, pending Mr. Cavin's response, which we'll then take it under advisement.

Gentlemen, thank you very much.

MR. CARR: Thank you, Mr. Stogner.

MR. CAVIN: Thank you, Mr. Stogner.

(Thereupon, these proceedings were concluded at 11:36 a.m.)

* * *

I hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. _____ heard by me on _____, 19____.

_____, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Division was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL June 4th, 2001.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002

STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:	)	CASE NO. 12,601
APPLICATION OF BETTIS, BOYLE AND STOVALL TO REOPEN CASE 12,601 AND AMEND ORDER NO. R-11,573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE PROPOSED WELL FOR PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO	)	

OFFICIAL EXHIBIT FILE

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

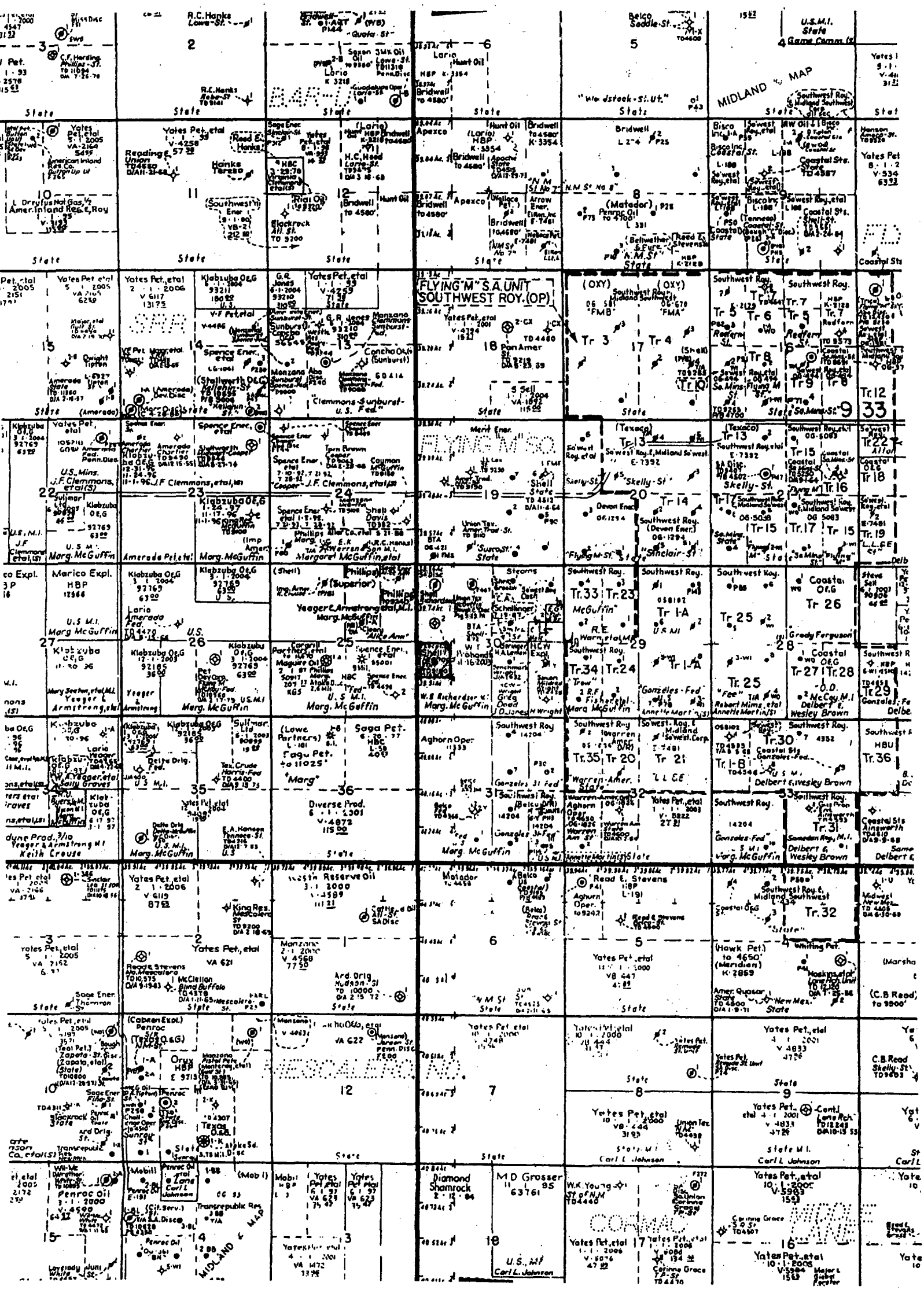
May 31st, 2001

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, May 31st, 2001, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

McGuffin Prospect- Land Plat



Initial Drill-site - Bettis, Boyle & Stovall et al 83.456% committed

BEFORE THE OIL CONSERVATION DIVISON
Santa Fe, New Mexico
Case No. 12601 Exhibit No. 1
Submitted by:
Bettis, Boyle & Stovall
Hearing Date: May 31, 2001

060199

McGuffin "C" #1
South Flying M
W/2 Section 30-T9S-R33E

Sunwest Oil & Gas, Inc.	3/20	=	15.00%
Larry Kent Kirby	1/320	=	.3125%
Thomas Wiley Neal, III, Trustee	1/80	=	1.25%

BEFORE THE OIL CONSERVATION DIVISON
Santa Fe, New Mexico
Case No. 12601 Exhibit No. 2
Submitted by:
Bettis, Boyle & Stovall
Hearing Date: May 31, 2001

010190

BEFORE THE OIL CONSERVATION DIVISION
NEW MEXICO ENERGY, MINERALS AND
NATURAL RESOURCES DEPARTMENT

APPLICATION OF BETTIS, BOYLE & STOVALL FOR COMPULSORY POOLING LEA COUNTY, NEW MEXICO.

CASE NO. 12601

AFFIDAVIT

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

William F. Carr, attorney in fact and authorized representative of Bettis, Boyle & Stovall, the Applicant herein, being first duly sworn, upon oath, states that notice has been given to all interested persons entitled to receive notice of this application under Oil Conservation Division rules, and that notice has been given at the addresses shown on Exhibit "A" attached hereto.

William F. Carr

SUBSCRIBED AND SWORN to before me this 29th day of May, 2001.

Barbara Ann Hart
Notary Public

My Commission Expires:
March 8, 2004

HOLLAND & HART LLP
and
CAMPBELL & CARR
ATTORNEYS AT LAW

DENVER • ASPEN
BOULDER • COLORADO SPRINGS
DENVER TECH CENTER
BILLINGS • BOISE • CASPER
CHEYENNE • JACKSON HOLE
SALT LAKE CITY • SANTA FE
WASHINGTON, D.C.

P.O. BOX 2208
SANTA FE, NEW MEXICO 87504-2208
110 NORTH GUADALUPE, SUITE 1
SANTA FE, NEW MEXICO 87501-6525

TELEPHONE (505) 988-4421
FACSIMILE (505) 983-6043

Michael H. Feldewert

mfeldewert@hollandhart.com

May 10, 2001

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

TO: AFFECTED INTEREST OWNERS

Re: Case No. 12601, Lea County, NM. Application of Bettis, Boyle & Stovall to Re-open Order No. R-11573 to amend the spacing units and to address the appropriate royalty burdens on the well for purposes of the charge for risk involved in drilling said well.

Ladies and Gentlemen:

This letter is to advise you that Bettis, Boyle & Stovall has filed the enclosed application with the New Mexico Oil Conservation Division. This application has been set for hearing before a Division Examiner on May 31, 2001. You are not required to attend this hearing, but as an owner of an interest that may be affected by this application, you may appear and present testimony. Failure to appear at that time and become a party of record will preclude you from challenging the matter at a later date.

Parties appearing in cases are required by Division Rule 1208.B to file a Prehearing Statement three days in advance of a scheduled hearing. This statement must include: the names of the parties and their attorneys; a concise statement of the case; the names of all witnesses the party will call to testify at the hearing; the approximate time the party will need to present its case; and identification of any procedural matters that are to be resolved prior to the hearing.

Very truly yours,

Michael H. Feldewert
ATTORNEYS FOR BETTIS, BOYLE & STOVALL

MHF/ras
Enclosure

090198

EXHIBIT A

Stephens Production Company
Post Office Box 2407
Fort Smith, Arkansas 72902

Thomas Wiley Neal III, Trustee of the
Thomas Wiley Neal III Revocable Trust
1623 Girard, SE
Albuquerque, New Mexico 87106

Addiline Royse
28800 South 597 Road
Grove, Oklahoma 74344

Dan Girand
1405 Mossman Drive
Roswell, New Mexico 88201

Larry Kent Kirby
3409 West Wildwood Drive
Tucson, Arizona 85701

Sun-West Oil & Gas, Inc.
Post Office Box 788
Hobbs, New Mexico 88241-0788
Attn: Mr. Shane Spear, Pres.

Gulf Coast Oil & Gas, Inc.
Post Office Box 1684
Midland, Texas 79702-1684
Attn: Mr. Shane Spear, Pres.

U.S. Postal Service
CERTIFIED MAIL RECEIPT
(Domestic Mail Only; No Insurance Coverage Prov

MHF 368

Postage	$ .34
Certified Fee	1.90
Return Receipt Fee (Endorsement Required)	1.50
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$ 3.74

DE VARGAS CTR STA SANTA FE NM Postmark Here MAY 10 2

USPS - 8

Rec
Stre Dan Girand
1405 Mossman Drive
City Roswell, New Mexico 88201

PS F

7000 0600 0024 3128 7935

SENDER: *COMPLETE THIS SECTION*

- Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired.
- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

1. Article Addressed to:

Dan Girand
1405 Mossman Drive
Roswell, New Mexico 88201

COMPLETE THIS SECTION ON DELIVERY

A. Received by *(Please Print Clearly)* B. Date of D 5-14-

C. Signature
X Dan Girand ☐ Age ☐ Add

D. Is delivery address different from item 1? ☐ Yes
If YES, enter delivery address below: ☐ No

3. Service Type
☒ Certified Mail ☐ Express Mail
☐ Registered ☒ Return Receipt for Merch
☐ Insured Mail ☐ C.O.D.

4. Restricted Delivery? *(Extra Fee)* ☐ Yes

2. Article Number *(Copy from service label)*
7000 0600 0024 3128 7935

U.S. Postal Service
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Return Receipt Fee (Endorsement Required)	1.50
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$ 3.74

DE VARGAS CTR STA SANTA FE NM Postmark Here MAY 10 2001

USPS - 87594

Rec
Stre Gulf Coast Oil & Gas, Inc.
Post Office Box 1684
City, Midland, Texas 79702-1684
Attn: Mr. Shane Spear, Pres.

PS F Instructions

7000 0600 0024 3128 7911

SENDER: *COMPLETE THIS SECTION*

e items 1, 2, and 3. Also complete
Restricted Delivery is desired.
ur name and address on the reverse
ve can return the card to you.
his card to the back of the mailpiece,
e front if space permits.

dressed to:

oast Oil & Gas, Inc.
ffice Box 1684
nd, Texas 79702-1684
tn: Mr. Shane Spear, Pres.

COMPLETE THIS SECTION ON DELIVERY

A. Received by *(Please Print Clearly)* B. Date of D
LURENE SPEAR 5/1

C. Signature
X Lurene Spear ☐ Ager ☒ Addr

D. Is delivery address different from item 1? ☐ Yes
If YES, enter delivery address below: ☐ No

3. Service Type
☒ Certified Mail ☐ Express Mail
☐ Registered ☒ Return Receipt for Merch
☐ Insured Mail ☐ C.O.D.

4. Restricted Delivery? *(Extra Fee)* ☐ Yes

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0600 0024 3128 7911

3811, July 1999 Domestic Return Receipt 102595-99-

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(Domestic Mail Only; No Insurance Coverage Provided)

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Return Receipt Fee (Endorsement Required)	1.50
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$ 3.74

DE VARGAS CTR STA SANTA FE NM Postmark Here MAY 10 2001

USPS - 87594

Re
Str Larry Kent Kirby
3409 West Wildwood Drive
Cit Tucson, Arizona 85701

BS

7000 0600 0024 3128 7928

MAIL RETURNED
NOT DELIVERED

00 200

U.S. Postal Service
CERTIFIED MAIL RECEIPT
(Domestic Mail Only; No Insurance Coverage Provided)

7000 0600 0024 3128 2942

MHF 368

Postage	$ .34
Certified Fee	1.90
Return Receipt Fee (Endorsement Required)	1.50
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$ 3.74

DE VARGAS CTR STA SANTA FE NM
MAY 10 2001
Postmark Here
USPS - 87594

Recipient: Thomas Wiley Neal III, Trustee of the
Street: Thomas Wiley Neal III Rev. Trust
City, State: 1623 Girard, SE
Albuquerque, New Mexico 87106

PS Form ... Instructions

Mail Returned
Not delivered

U.S. Postal Service
CERTIFIED MAIL RECEIPT
(Domestic Mail Only; No Insurance Coverage Pro

7000 0600 0024 3128 2942

MHF 368

Postage	$ .34
Certified Fee	1.90
Return Receipt Fee (Endorsement Required)	1.50
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$ 3.74

DE VARGAS CTR STA SANTA FE
MAY 10
Postmark Here
USPS -

Recipient: Addiline Royse
Street: 28800 South 597 Road
City, State: Grove, Oklahoma 74344

PS Form ...

SENDER: *COMPLETE THIS SECTION*

- Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired.
- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

1. Article Addressed to:

Addiline Royse
28800 South 597 Road
Grove, Oklahoma 74344

COMPLETE THIS SECTION ON DELIVERY

A. Received by *(Please Print Clearly)* B. Date of D 5/14

C. Signature
X Addiline Royse ☐ Age ☐ Add

D. Is delivery address different from item 1? ☐ Yes
If YES, enter delivery address below: ☐ No

3. Service Type
☒ Certified Mail ☐ Express Mail
☐ Registered ☒ Return Receipt for Merch
☐ Insured Mail ☐ C.O.D.

4. Restricted Delivery? *(Extra Fee)* ☐ Yes

2. Article Number *(Copy from service label)* 7000 0600 0024 3128 2942

PS Form 3811, July 1999 Domestic Return Receipt 102595-99-

U.S. Postal Service
CERTIFIED MAIL RECEIPT
(Domestic Mail Only; No Insurance Coverage Provided)

ete items 1, 2, and 3. Also complete
if Restricted Delivery is desired.

A. Received by *(Please Print Clearly)* Robert L. Bell B. Date of D 5-14-0

00 201

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

APPLICATION OF BETTIS, BOYLE & STOVALL TO REOPEN CASE 12601 AND AMEND ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE PROPOSED WELL FOR THE PURPOSE OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO. **CASE 12601 (REOPENED)**

BETTIS, BOYLE & STOVALL'S
HEARING MEMORANDUM

By Order No. R-12601 dated April 26, 2001, the Oil Conservation Division granted the application of Bettis, Boyle & Stovall and, pursuant to the provisions of Section 70-2-17(C) of the Oil and Gas Act, pooled all uncommitted mineral interests, whatever they may be, under certain spacing units in the W/2 SW/4 of Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico. Sun-West Oil and Gas, Inc. ("Sun-West") owned 15% of the mineral interest under the pooled acreage. With this application, Bettis, Boyle & Stovall asks the Oil Conservation Division[1] to determine the appropriate royalty burdens on the Sun-West interest for this burden will impact the charge for risk paid by Sun-West and, therefore, the economics of the development of this property. Sun-

[1] In this memorandum the term Oil Conservation Division also is intended to include the Oil Conservation Commission.

West opposes this application for the stated reason, "there is no legal basis for taking its property." *See*, Sun-West Prehearing Statement.

FACTS:

Sun-West owned 15% of the unleased mineral interest in certain acreage in Section 30, including the acreage pooled by Order No. R-12601. Commencing December 15, 2000, Bettis Boyle & Stovall attempted to lease the Sun-West interest or otherwise reach a voluntary agreement with Sun-West for the development of the W/2 SW/4 of Section 30. No agreement could be reached concerning an appropriate royalty burden for the Sun-West tract; and on January 30, 2001, pursuant to the compulsory pooling provisions of the Oil and Gas Act, Bettis, Boyle & Stovall filed an application with the Oil Conservation Division. The application and notice of hearing thereon were sent by Certified Mail which was received by Sun-West on February 6, 2001. On February 15, 2001, Sun-West leased its mineral interest in the W/2 SW/4 of Section 30 to Gulf Coast Oil & Gas Company and made subject to a **27.5%** royalty burden.

NEW MEXICO COMPULSORY POOLING STATUTE:

The New Mexico Oil and Gas Act authorizes the Oil Conservation Division to pool oil and gas interests where the owners "... have not agreed to pool their interests, and where one such separate owner, or owners, ... has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply...." This statute also provides that a Division pooling order "...may

include a charge for risk... which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well."

In carrying out its statutory duties, the Division has been granted broad authority. *See*, Santa Fe Exploration Co. v. Oil Conservation Commission, 114 N.M. 103, 835 P.2d 819 (1992); Continental Oil Company v. Oil Conservation Commission, 70 N.M. 310, 373 P.2d 809 (1962).

In the past the Oil Conservation Division has been presented with similar situations where an interest owner has burdened its acreage in a way which undercuts its pooling authority. In those cases, the Division has not allowed that to happen.[2] It has recognized that the creation of a non-cost bearing interest out of the working interest, like the royalty interest in this case, decreases the risk borne by the person creating this interest and increases the risk for the remaining working interest owners in the well. It is nothing more than an attempt through private agreement to circumvent or preclude the Division from exercising of its

---

[2] In Case 12087, Nearburg Exploration Company, L.L.C. sought an order pooling certain lands in Lea County, New Mexico. The evidence showed that Merit Energy Company had an internal "nets profits interest" which might unnecessarily burden Merit's working interest. Since this "net profits interest" would not be subject to bear any of the costs of drilling or completing the well nor be subject to the risk penalty imposed by a pooling order, the Division ordered that this net profits interest be liable for its share of the drilling and completion costs and that it be subject to the risk factor penalty. Order No. R-11109, Findings (7) through (9),December 11, 1998.

In Case No. 8640, Order No. R-7998, August 8, 1985, Caulkins Oil Company obtained an order which required the "voluntary reduction" of the overriding royalty interest which was considered to be excessive.

jurisdiction and authority. *See,* Patterson v. Stanolind Oil & Gas Co. 182 Okla 155, 77 P2d 83 (1938).

In this case, Bettis, Boyle & Stovall had advised Sun-West that the royalty burden it sought was unacceptable and at the April 19th Examiner hearing on this application testified that the creation of a 27.5% royalty burden on the Sun-West interest would put the project in unfavorable economics. *See,* Testimony of Stubbs, Tr. at 32. Having been unsuccessful in negotiating an agreement with Bettis, Boyle & Stovall and after receiving the application for compulsory pooling, Sun-West imposed the royalty burden on this acreage through a private agreement with Gulf-Coast.

This negotiation of this lease was not an arms-length transaction. It was an attempt to circumvent the Oil Conservation Division. As the testimony showed at the April 19th Examiner hearing in this matter, a review of the Armstrong Oil Directory shows Sun-West and Gulf Coast have the same officers, same address and same phone numbers. Furthermore, when Gulf Coast was contacted by Bettis, Boyle & Stovall, the person who responded was the same person who had previously responded for Sun-West. He confirmed that these entities were the same. *See,* Transcript in Case 12601, April 19, 2001, at pp. 16-17.

Bettis, Boyle & Stovall asks the Division to treat the Sun-West interest as it was on the day this compulsory pooling application was filed -- as an unleased mineral interest. This is appropriate under New Mexico law and under the

decision in Case No. 11510, R-10672-A for in that case the Division recognized that in compulsory pooling proceedings, the status of a mineral interest is its status at the time the application was filed. The Sun-West interest was unleased on January 30th and as such must be treated under the Oil and Gas Act as a seven-eighth's working interest and a one-eighth's royalty interest[3].

The Oil Conservation Division has jurisdiction over all interest owners in a spacing and proration unit[4] and the power to reduce burdens imposed to circumvent its jurisdiction. It has exercised this authority in the past to reduce unreasonable non-cost bearing burdens on acreage subject to pooling and should do so now. To do otherwise would encourage parties subject to a pooling hearing to attempt to circumvent Division jurisdiction with a private agreement.

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[3] "If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest, and he shall in all events be paid one-eighth of all production from the unit and creditable to his interest." NMSA 1978, Section 70-2-17(c).

[4] NMSA 1978, Section 70-2-17(c) authorizes compulsory pooling where "...two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof embraced within such spacing or proration unit..."

Respectfully submitted,

HOLLAND & HART LLP
AND
CAMPBELL & CARR

By: William F. Carr

ATTORNEYS FOR BETTIS,
BOYLE & STOVALL

CERTIFICATE OF SERVICE

I certify that on this 31st day of May, 2001, I hand delivered a copy of this Hearing Memorandum to the following counsel of record.

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William F. Carr

PROPOSED FINDINGS FOR DIVISION ORDER NO. R-11573-A:

(__) Bettis, Boyle & Stovall was unable to reach a voluntary agreement for the development of the subject spacing and proration units because, although Sun-West was willing to lease its interest in the acreage, it demanded a royalty rate which was so high it would have jeopardized the drilling of the well. (April 19, 2001 Examiner Hearing, Testimony of Stubbs at Tr. 32).

(__) Bettis, Boyle & Stovall testified that on the date its application was filed seeking an order pooling the subject spacing units in the W/2 SW/4 of said Section 30, Sun-West Oil & Gas, Inc., was an unleased mineral owner of 15% of the mineral interests in these tracts. (April 19, 2001 Examiner Hearing, Testimony of Maloney at __).

(__) Pursuant to the provisions of the Oil and Gas Act, when an unleased mineral interest is pooled, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest and thereby not subject to payment of the costs of drilling and completing the well or charge for risk imposed by the pooling order. (NMSA 1978, Section 70-2-17(C)).

(__) Notice of the Bettis, Boyle & Stovall compulsory pooling application and the hearing thereon was sent by certified mail and received by Sun-West Oil & Gas, Inc. on February 6, 2001. (April 19, 2001 Examiner Hearing, Bettis, Boyle & Stovall Exhibit No. 6).

(__) On February 15, 2001, Sun-West leased its 15% mineral interest under the W/2 SW/4 of Section 30 to Gulf Coast Oil & Gas Company. (April 19, 2001 Examiner Hearing, Bettis, Boyle & Stovall Exhibit No. 4).

(__) Gulf Coast Oil & Gas Company has the same officers, address and owners as Sun-West. (April 19, 2001 Examiner Hearing, Testimony of Maloney at ___).

(__) The lease of the 15% mineral interest from Sun-West to Gulf Coast was not at arms length, but for the purpose of burdening the interest with an excessive royalty interest, was for the purpose of circumventing the pooling authority of the Division.

(__) At the time the Bettis, Boyle & Stovall compulsory pooling application was filed, Sun-West's 15% mineral interest in the subject lands was unleased and should be considered as seven-eighths working interest and one-eighth royalty interest. (See, Order No. R-10672-A, Conclusions of Law No. 3, January 16, 1997).

(__) Gulf Coast's seven-eighth's working interest, including any royalty interest carved out of this working interest should be liable for its share of drilling and completion costs and be subject to the risk factor penalty.

STATE OF NEW MEXICO
ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 12087
ORDER NO. R-11109

APPLICATION OF NEARBURG EXPLORATION COMPANY, L.L.C. FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on November 19, 1998, at Santa Fe, New Mexico, before Examiner Mark W. Ashley.

NOW, on this 11th day of December, 1998, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given and the Division has jurisdiction of this case and its subject matter.

(2) The applicant, Nearburg Exploration Company, L.L.C. ("Nearburg"), seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying Section 3, Township 20 South, Range 33 East, NMPM, Lea County, New Mexico, in the following manner:

(a) Lots 1 through 4, and the S/2 N/2 (N/2 equivalent) to form a standard 319.96-acre gas spacing and proration unit for any formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include the Undesignated East Gem-Morrow Gas Pool, Undesignated West Teas-Morrow Gas Pool, and Undesignated Teas-Pennsylvanian Gas Pool;

(b) Lots 1 and 2, and the S/2 NE/4 (NE/4 equivalent) to form a standard 159.81-acre gas spacing and proration unit for any formations and/or pools developed on 160-acre spacing within that vertical extent; and

(c) the SW/4 NE/4 to form a standard 40-acre oil spacing and proration unit for any formations and/or pools developed on 40- acre spacing within that vertical extent, which presently include the Undesignated Gem-Bone Spring Pool and the Undesignated Teas-Bone Spring Pool.

(3) The units are to be dedicated to the applicant's proposed Viper "3" Federal Well No. 1 to be drilled and completed in accordance with Division Rule 111 (directional wellbore) from a surface location 2200 feet from the South line and 1600 feet from the East line to a standard subsurface location 1650 feet from the North line and 1650 feet from the East line.

(4) All of Section 3 consists of a single federal oil and gas lease with the N/2 of this section being within a "measured potash" area where the Bureau of Land Management will not allow a well to be drilled vertically but will allow the well to be located and drilled directionally as proposed by Nearburg.

(5) The applicant has the right to drill its Viper "3" Federal Well No. 1 in the proposed spacing and proration units.

(6) The interest owners in the proposed spacing and proration units who have not agreed to pool their interests did not appear at the hearing.

(7) Nearburg testified that Merit Energy Company ("Merit") had an internal "net profits interest" the details of which had not been disclosed to Nearburg which might be an unnecessary burden on Merit's working interest.

(8) Nearburg requested that Merit's working interest, including its "net profits interest," be subject to the risk factor penalty.

(9) Merit's working interest, including any "net profits interest," carved out of its working interest, should be liable for its share of drilling and completion costs and be subject to the risk factor penalty.

(10) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste, and to afford to the owner of each interest in the units the opportunity to recover or receive without unnecessary expense its just and fair share of the production in any pool completion resulting from this order, this application should be approved by pooling all mineral interests, whatever they may be, within the units.

(11) Nearburg should be designated the operator of the well and units.

(12) Any non-consenting working interest owner should be afforded the opportunity to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production.

(13) Any non-consenting working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

(14) Any non-consenting working interest owner should be afforded the opportunity to object to the actual well costs but actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(15) Following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(16) Reasonable charges for supervision (combined fixed rates) should be fixed at $6,000.00 per month while drilling and $600.00 per month while producing. The operator should be authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(17) All proceeds from production from the well that are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(18) If the operator of the pooled units fails to commence drilling the well to which the units are dedicated on or before March 15, 1999, or if all the parties to this forced pooling reach voluntary agreement subsequent to entry of this order, this order should become of no effect.

(19) The operator of the well and units should notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

IT IS THEREFORE ORDERED THAT:

(1) All mineral interests, whatever they may be, from the surface to the base of the Morrow formation underlying Section 3, Township 20 South, Range 33 East, NMPM, Lea County, New Mexico, are hereby pooled in the following manner:

(a) Lots 1 through 4, and the S/2 N/2 (N/2 equivalent) to form a standard 319.96-acre gas spacing and proration unit for any formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include the Undesignated East Gem-Morrow Gas Pool, Undesignated West Teas-Morrow Gas

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Pool, and Undesignated Teas-Pennsylvanian Gas Pool;

(b) Lots 1 and 2, and the S/2 NE/4 (NE/4 equivalent) to form a standard 159.81-acre gas spacing and proration unit for any formations and/or pools developed on 160-acre spacing within that vertical extent; and

(c) the SW/4 NE/4 to form a standard 40-acre oil spacing and proration unit for any formations and/or pools developed on 40- acre spacing within that vertical extent, which presently include the Undesignated Gem-Bone Spring Pool and the Undesignated Teas-Bone Spring Pool.

(2) The units are to be dedicated to the Nearburg's proposed Viper "3" Federal Well No. 1 to be drilled and completed in accordance with Division Rule 111 (directional wellbore) from a surface location 2200 feet from the South line and 1600 feet from the East line to a standard subsurface location 1650 feet from the North line and 1650 feet from the East line.

PROVIDED HOWEVER THAT, the operator of the units shall commence drilling the well on or before March 15, 1999, and shall thereafter continue drilling the well with due diligence to a depth sufficient to test the Morrow formation.

PROVIDED FURTHER THAT, in the event the operator does not commence drilling the well on or before March 15, 1999, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause shown.

PROVIDED FURTHER THAT, should the well not be drilled to completion or abandoned within 120 days after commencement thereof, the operator shall appear before the Division Director and show cause why Ordering Paragraph (1) should not be rescinded.

(3) Nearburg is hereby designated the operator of the well and units.

(4) After the effective date of this order and within 90 days prior to commencing the well, the operator shall furnish the Division and each known working interest owner in the units an itemized schedule of estimated well costs.

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(5) Within 30 days from the date the schedule of estimated well costs is furnished, any non-consenting working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(6) The operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90 days following completion of the well. If no objection to the actual well costs is received by the Division and the Division has not objected within 45 days following receipt of the schedule, the actual well costs shall be the reasonable well costs; provided, however, that if there is an objection to actual well costs within the 45-day period the Division will determine reasonable well costs after public notice and hearing.

(7) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of estimated well costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator its share of the amount that estimated well costs exceed reasonable well costs.

(8) The operator is hereby authorized to withhold the following costs and charges from production:

(a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner, including any "net profits interests" carved out of that working interest, who has not paid its share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished; and

(b) as a charge for the risk involved in drilling the well, 200 percent of the above costs.

(9) The operator shall distribute the costs and charges withheld from production to the parties who advanced the well costs.

(10) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6,000.00 per month while drilling and $600.00 per month while producing. The operator is hereby authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(11) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order.

(12) Any well costs or charges that are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

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(13) All proceeds from production from the well that are not disbursed for any

reason shall immediately be placed in escrow in Lea County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership. The operator shall notify the Division of the name and address of the escrow agent within 30 days from the date of first deposit with the escrow agent.

(14) Should all the parties to this forced pooling order reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(15) The operator of the well and units shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(16) Jurisdiction is hereby retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

LORI WROTENBERY
Director

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STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 8640
Order No. R-7998

APPLICATION OF CAULKINS OIL COMPANY FOR COMPULSORY POOLING, RIO ARRIBA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8 a.m. on July 2, 1985, at Santa Fe, New Mexico, before Examiner Gilbert P. Quintana.

NOW, on this 8th day of August, 1985, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) The applicant, Caulkins Oil Company, seeks an order pooling all mineral interests in the Basin-Dakota and Blanco-Mesaverde Pools underlying the N/2 of Section 20, Township 26 North, Range 6 West, NMPM, Rio Arriba County, New Mexico, to form a standard 320-acre gas spacing and proration unit in both pools, and an order pooling all mineral interests in the Pictured Cliffs and Chacra formations underlying the NE/4 of said Section 20, to form a standard 160-acre gas spacing and proration unit in both formations, to be dedicated to a well to be drilled at a standard location thereon.

(3) The applicant further seeks approval to downhole commingle Blanco-Mesaverde and Basin-Dakota production, to downhole commingle Pictured Cliffs and Chacra production, and finally to dually complete through parallel strings of tubing both commingled production streams in the subject well.

(4) The applicant has the right to drill and proposes to drill a well at a standard location in the NE/4 of Section 20.

(5) There is an interest owner in the proposed proration unit, El Paso Natural Gas Company/Meridian Oil, Inc., who has not agreed to pool its interest.

(6) The N/2 of said Section 20 is a standard 320-acre spacing and proration unit for the Blanco-Mesaverde and Basin-Dakota Pools and the NE/4 of the same section is a standard 160-acre spacing and proration unit for the Pictured Cliffs and Chacra formations.

(7) Evidence was presented establishing that 120 acres of the proposed 320-acre spacing unit, being the N/2 NW/4 and SW/4 NW/4 of said Section 20, is under lease to Meridian Oil, Inc. and/or El Paso Natural Gas Company, and that El Paso Natural Gas Company, predecessor in interest to Meridian Oil, Inc., hereafter referred to as "Meridian", created overriding royalty burdens on said 120 acres of $3.96 and $3.73 per mcf of gas.

(8) Evidence was also presented that for each $858.37 of income per day attributable to Meridian's interest in said well, Meridian must pay out $1,508.76 per day, leaving Meridian with a negative daily working interest of $650.39.

(9) If Meridian proved to be a non-consenting participant in the proposed well, payout for its interest would never occur.

(10) Participating working interest owners in the proposed spacing unit will be required to bear the cost and risk of drilling the well in which one-half interest of the well will never pay out.

(11) Said overriding royalty burden placed on Meridian's acreage is in excess of reasonable overriding royalties based on current economic and marketing conditions.

(12) Compulsory pooling of the proposed proration unit under such conditions would not be just or reasonable.

(13) To compulsorily pool the entire N/2 of said Section 20 in the Blanco-Mesaverde and Dakota formations would cause the operator of the well to bear an unreasonable, and therefore unnecessary, cost burden as to that portion of the proration unit bearing said overriding royalty.

(14) In order to protect correlative rights, prevent waste, and to avoid compulsory pooling under terms that are not just or reasonable, any compulsory pooling order issuing in this case should provide for voluntary reduction of the overriding royalty for the N/2 NW/4 and the SW/4 NW/4 of said Section 20 to a reasonable figure, within a reasonable time, or for the pooling of the N/2 of said Section 20 exclusive of the N/2 NW/4 and the SW/4 NW/4.

(15) Subject to the conditions contained in Finding No. (14) above, to avoid the drilling of unnecessary wells, to prevent waste and to protect correlative rights and to afford the owner of each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the gas in any pool thereunder, the subject application should be approved by pooling all mineral interests, whatever they may be, within said units in the Basin-Dakota and Blanco-Mesaverde Pools and the Pictured Cliffs and Chacra formations.

(16) The applicant, Caulkins Oil Company, should be designated the operator of the subject well and unit.

(17) Any non-consenting working interest owner should be afforded the opportunity to pay his share of estimated and actual well costs to the operator in lieu of paying his share of reasonable well costs out of production.

(18) Any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his share of the reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling and completing the subject well.

(19) Any non-consenting working interest owner should be afforded the opportunity to object to the actual well costs, but actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(20) Following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that estimated well costs reasonably paid exceed reasonable well costs.

(21) A cost of $3,000.00 per month while drilling and $400.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(22) All proceeds from production from the subject well which are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(23) Upon failure of the operator of said pooled units to commence drilling of the well to which said units are dedicated on or before November 1, 1985, the order pooling said unit should become null and void and of no effect whatsoever.

(24) The applicant's request to downhole commingle the Blanco-Mesaverde and Basin-Dakota Pools, and the Pictured Cliffs and Chacra formations, and to dually complete the respective commingled streams with parallel strings of tubing will not result in reservoir damage, waste, or the violation of any correlative rights.

(25) The applicant's request to complete the subject well as described in Finding No. (24) above should be granted provided the supervisor of the Division's Aztec District Office is consulted in approving the specific details of such a completion.

(26) The applicant should consult with the supervisor of the Division's Aztec District Office to formulate a reasonable allocation of production from each respective producing zone and an assignment of an allowable to the well.

(27) The results of the allocation determination should be delivered to the Division's Santa Fe office for incorporation into the records of this case.

(28) Approval of the subject application will afford the applicant the opportunity to produce its just and equitable share of the gas in the affected pool, will prevent economic loss caused by the drilling of unnecessary wells, avoid the augmentation of risk arising from the drilling of an excessive number of wells, and will otherwise prevent waste and protect correlative rights.

IT IS THEREFORE ORDERED THAT:

(1) All mineral interests, whatever they may be, in the Blanco-Mesaverde and Basin-Dakota Pools underlying the N/2 of Section 20, Township 20 North, Range 6 West, NMPM, Rio Arriba County, New Mexico, are hereby pooled to form a standard 320-acre spacing and proration unit and all mineral interests, whatever they may be, in the Pictured Cliffs and Chacra formations underlying the NE/4 of said Section 20 are hereby pooled to form a standard 160-acre spacing and proration unit to be dedicated to a well to be drilled at a standard location thereon.

PROVIDED HOWEVER THAT, the operator of said unit shall commence drilling of said well on or before November 1, 1985, and shall thereafter continue the completion of said well with due diligence.

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well on or before November 1, 1985, Order (1) of this order shall be null and void and of no effect whatsoever.

PROVIDED FURTHER THAT, should said well not be completed within 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Order (1) of this order should not be rescinded.

(2) Caulkins Oil Company is hereby designated the operator of the subject well and unit.

(3) Within 30 days from the date the schedule of estimated well costs is furnished to Meridian Oil, Inc., it shall make an election to voluntarily reduce overriding royalty not in excess of a total 12.5 percent for its 120-acre lease, and in the event it does not make that election, the N/2 NW/4 and the SW/4 NW/4 of said Section 20 shall be excluded from the proration and spacing unit and the Division shall upon written request automatically

approve the unit as a non-standard proration and spacing unit consisting of that portion of the N/2 of said Section 20 excluding the N/2 NW/4 and the SW/4 NW/4.

(4) The operator shall notify the Division of the decision of Meridian Oil, Inc., requesting approval of the non-standard proration unit if said party chooses not to or is unable to amend its overriding royalty interest.

(5) After the effective date of this order and within 90 days prior to commencing said well, the operator shall furnish the Division and each known working interest owner in the subject units an itemized schedule of estimated well costs.

(6) Within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(7) The operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90 days following completion of the well; if no objection to the actual well costs is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual well costs shall be the reasonable well costs; provided however, that if there is an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(8) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs in advance as provided above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

(9) The operator is hereby authorized to withhold the following costs and charges from production:

(A) The pro rata share of reasonable well costs attributable to each non-consenting working

interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(B) As a charge for the risk involved in the drilling of the well, 200 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(10) The operator shall distribute said costs and charges withheld from production to the parties who advanced the well costs.

(11) $3,000.00 per month while drilling and $400.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(12) Any unsevered mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under the terms of this order.

(13) Any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(14) All proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Rio Arriba County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; the operator shall notify the Division of the name and address of said escrow agent within 30 days from the date of first deposit with said escrow agent.

(15) The applicant, Caulkins Oil Company, is hereby authorized to downhole commingle the Blanco-Mesaverde and Basin-Dakota Pools, downhole commingle the Pictured Cliffs and Chacra formations, and dually complete the respective commingled streams with parallel strings of tubing provided the supervisor of the Division's Aztec District Office is consulted in approving the specific details of such a completion.

(16) The applicant shall consult the supervisor of said district office to formulate a reasonable allocation of production from each respective producing zone and an assignment of allowable to the well.

(17) The determined production allocation factors for each producing zone shall be delivered to the Division's Santa Fe office for incorporation into the records of this case.

(18) Jurisdiction of this cause is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

R. L. STAMETS
Director

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STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
COMMISSION OF NEW MEXICO FOR
THE PURPOSE OF CONSIDERING:

CASE NO. 8640 DE NOVO
Order No. R-7998-A

APPLICATION OF CAULKINS OIL COMPANY
FOR COMPULSORY POOLING, DOWNHOLE
COMMINGLING, AND DUAL COMPLETION,
RIO ARRIBA COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 8:15 a.m. on August 7, 1986, at Santa Fe, New Mexico, before the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission."

NOW, on this 21st day of August, 1986, the Commission, a quorum being present, having considered the testimony presented and the exhibits received at said hearing, and being fully advised in the premises,

FINDS THAT:

On August 7, 1986, an unopposed request for dismissal of this case de novo was received and such request should be granted.

IT IS THEREFORE ORDERED THAT:

Case 8640 de novo is hereby dismissed and Order No. R-7998 is hereby continued in full force and effect.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

JIM BACA, Member

ED KELLEY, Member

R. L. STAMETS, Chairman and
Secretary

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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

DE NOVO
CASE NO. 11510
Order No. R-10672-A

APPLICATION OF BRANKO, INC. ET AL. TO REOPEN CASE NO. 10656 (ORDER NO. R-9845) CAPTIONED "APPLICATION OF MITCHELL ENERGY CORPORATION FOR COMPULSORY POOLING AND AN UNORTHODOX GAS WELL LOCATION, LEA COUNTY, NEW MEXICO."

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9:00 a.m. on January 16, 1997, at Santa Fe, New Mexico, before the Oil Conservation Commission of the State of New Mexico, hereinafter referred to as the **"Commission"** on Mitchell Energy Corporation's **(Mitchell)** Request for a *De Novo* Hearing in Case No. 11510 (Division Order R-10672) filed with the Commission on October 30, 1996.

Mitchell was represented by W. Thomas Kellahin of Kellahin & Kellahin; Branko, Inc. et al. was represented by Harold D. Stratton, Jr. of Stratton & Cavin, P.A. The New Mexico Oil Conservation Division of the New Mexico Energy, Minerals and Natural Resources Department **(OCD)** was represented by Rand Carroll.

Now, on this 19th day of March, 1997, the Commission, a quorum being present, having considered the record and being fully advised in the premises,

FINDS THAT:

A. Summary of Proceedings

The procedural history of this case is long and complicated so that a summary of the proceedings to date is necessary:

1) On December 8, 1992, Mitchell filed an Application for Compulsory Pooling and an Unorthodox Gas Well Location **(1992 Application)** with the OCD pursuant to NMSA 1978, Section 70-2-17 and requested a hearing before a hearing examiner. The OCD assigned Case No. 10656 to this matter.

2) The 1992 Application was originally set for hearing by the OCD on January 7, 1993, and at Mitchell's request, the hearing was continued until January 21, 1993.

3) A hearing was held before Michael E. Stogner, an OCD hearing examiner, on January 21, 1993 **(1993 Hearing)**. Mitchell was represented by W. Thomas Kellahin of Kellahin & Kellahin; Strata Production Company, a New Mexico corporation **(Strata)**, appeared in opposition to the 1992 Application and was represented by Sealy H. Cavin, Jr. of Stratton & Cavin, P.A.

4) On February 15, 1993, the OCD Division Director entered Order No. R-9845 in Case No. 10656 which pooled all the mineral interests from the top of the Wolfcamp formation to the base of the Pennsylvanian formation, underlying the W/2 of Section 28, Township 20 South, Range 33 East, NMPM, Lea County to form a proration unit to be dedicated to its Tomahawk "28" Federal Com Well No. 1 **(Tomahawk 28 Well)**.

5) By fax on March 11, 1993, Strata requested a *de novo* hearing before the Commission pursuant to NMSA 1978, Section 70-2-13.

6) By fax on April 28, 1993, Strata withdrew its request for a *de novo* hearing of Case No. 10656 before the Commission. The Commission entered its order on April 29, 1993, dismissing the requested *de novo* hearing of Case No. 10656.

7) On January 31, 1996, a Motion to Reopen Case or, in the Alternative, Application for Hearing *De Novo* **(Motion)** in Case No. 10656, Order No. R-9845 was filed with the OCD by Harold D. Stratton of Stratton and Cavin, P.A. on behalf of the following: Branko, Inc., a New Mexico corporation; Duane Brown; S.H. Cavin; Robert W. Eaton; Terry and Barb Kramer, husband and wife; Landwest, a Utah general partnership; Candace McClelland; Stephen T. Mitchell; Permian Hunter Corporation, a New Mexico corporation; George L. Scott, III; Scott Exploration, Inc., a New Mexico corporation; Charles I. Wellborn; Winn Investments, Inc., a New Mexico corporation; Lori Scott Worrall; and Xion Investments, a Utah general partnership **(Branko)**.

8) On February 12, 1996, Mitchell filed a Reply to the Motion to Reopen Case No. 10656 **(Reply)**.

9) On May 2, 1996, a hearing **(1996 Hearing)** on the Motion to Reopen Case No. 10656 was held before OCD Hearing Examiner Stogner. The case was assigned a number, Case No. 11510. Branko was represented by Harold D. Stratton of Stratton & Cavin, P.A.; Mitchell was represented by Kellahin.

10) On October 2, 1996, the OCD Division Director entered Order No. R-10672 in Case No. 11510 which reopened Case No. 10656.

11) On October 30, 1996, Mitchell filed a Request for a Hearing *De Novo* of Case No. 11510, Order No. R-10672 before the Commission.

B. Summary of the Parties' Claims

1) Branko's claims as alleged in its Motion:

a) Mitchell failed to give proper notice to Branko, as required by law, of Mitchell's 1992 Application in Case No. 10656.

b) Mitchell failed to give proper notice as required by law of the OCD 1993 Hearing on Mitchell's 1992 Application.

c) Mitchell failed to provide Branko with an opportunity to participate in Mitchell's Tomahawk 28 Well located in what Branko refers to as the Strata North Gavilon Lease, a federal oil and gas lease **(Lease)**.

d) All of the entities referred to as "Branko" acquired and owned interests in the Lease on or before April 1, 1990, prior to the date Mitchell filed its 1992

Application with the OCD.

e) Branko's interests were made known to Mitchell by a letter dated January 13, 1993, and Mitchell otherwise had actual knowledge of Branko's interests.

f) Mitchell failed to comply with NMSA 1978, Section 70-2-17 (1995 Repl.)

g) OCD Order No. R-9845 in Case No. 10656 is void as to Branko as the OCD did not have jurisdiction over Branko because of Mitchell's failure to provide notice of the 1992 Application and notice of the 1993 Hearing.

Branko requests that the Commission:

a) reopen Case No. 10656 or, in the alternative grant Branko a hearing *de novo*; and

b) enjoin Mitchell from any operation on the Tomahawk 28 Well, including any workover, plug back or recompletion attempt which may adversely affect the interests of Branko in the well.

2) Mitchell's claims as alleged in its Reply:

a) Branko is not a party of record to OCD Case No. 10656, and Branko is not entitled to file for a *de novo* hearing in this case.

b) Branko's Motion to reopen OCD Case No. 10656 is a collateral attack on Order R-9845 and must be denied.

c) All the interests in the Lease have been pooled by Order R-9845 entered on February 15, 1993, and the time to appeal that order has run.

d) Branko did not have a protected property right in the Lease.

e) Branko is bound through Strata by OCD Order No. R-9845.

f) Mitchell requests the Commission deny Branko's Motion.

C. Findings of Fact from the January 16, 1997 hearing

1) Due public notice of this hearing was provided as required by law.

2) A quorum of the Commission was present for the hearing and has reviewed the evidence presented at the hearing.

3) Mitchell and Branko stipulated to the introduction of the evidence from the 1993 Hearing and the 1996 Hearing as well as exhibits introduced at the January 16, 1997 Commission hearing.

4) The parties did not present any testimony at the January 16, 1997 Commission hearing, but through counsel the parties made oral argument.

5) Branko was not a party of record to Case No. 10656.

6) Mitchell obtained a title opinion that showed that Strata was the owner of 100% of the record title and operating rights for the Lease, and Mark Murphy, president of Strata, confirmed that at the 1993 Hearing.

7) At the 1993 Hearing there was conflicting testimony regarding the nature of the interests, if any, obtained by the entities through Strata. Fifteen of these entities became the party "Branko" that moved to reopen Case No. 10656 in 1996.

a) Stephen J. Smith, Mitchell's landman, testified that Mark Murphy, president of Strata, "...always described them as silent partners...." (1993 Hearing Tr. p. 56). Smith also testified: "I understood that he [Murphy] was acting as a go-between, as I was." (1993 Hearing Tr. p 58). Smith also testified that Mitchell relied on the fact that Strata was the record title owner to 100 percent interest [of the tract in question], "...and his [Murphy's] representation to us that he spoke for these silent partners and was capable of binding them in an agreement." (1993 Hearing Tr. p. 61).

b) Mark Murphy testified that he informed Smith during a conversation on October 26, 1992, that Strata had other partners, and "...that until a deal, specific deal was negotiated that we [Strata] could recommend, that I couldn't represent those partners; that, however, historically, normally when we reached an agreement that we could recommend to our partners, they would, in most cases, go along with that deal, but I could not guarantee that." (1993 Hearing Tr. p. 122). He also testified that he never represented that he could bind the other parties until they approved the terms of the deal. (1993 Hearing Tr. p. 126).

On direct examination, Murphy was asked: "Who are these parties,

as a general rule?" Murphy responded: "As a general rule, they're long-term investors of Strata." (1993 Hearing Tr. p. 127). Murphy also testified that the entities identified in the January 13 letter, Mitchell Exhibit 17, were long-term partners of Strata. (1993 Hearing Tr. p. 129). Murphy also stated: "as a matter of fact, many times in leasehold situations like this, you don't immediately make assignments to all the parties until a well is drilled or some action taken. So if you do sell it, you only have to handle one assignment from Strata to whoever the purchaser is. If we [Strata] assign this out to all these parties, they would have to gather up --we'd have to gather up 15 assignments into Mitchell or to whomever." (1993 Hearing Tr. p. 130). Murphy testified that as of the date of the title opinion, Strata had not assigned out any "working interest ownership" in the lease. (1993 Hearing Tr. p. 141).

Murphy also acknowledged on cross-examination that as of the date of the title opinion Strata was the record title or leasehold holder and continued to be the owner of the federal lease record title and operating rights on the date of the January 1993 hearing. (1993 Hearing Tr. pp. 141, 142). However, Murphy testified that he never used the term "silent partners" in conversation with Mitchell; instead he recalled telling Mitchell that Strata had "partners in this lease." (1993 Hearing Tr. p. 142)

c) George L. Scott, Jr. testified that he owned some of the stock in Strata. He also stated that his organization, Scott Exploration, was "...involved with Strata in the sense that we (Scott Exploration) try to originate prospects, and Strata operates them." (1993 Hearing Tr. p. 153). Scott Exploration Inc., a New Mexico corporation, is one of the Branko group. Testimony from the 1993 Hearing does not reveal whether Scott meant that he, as an individual, owned shares of stock in Strata or whether his organization, Scott Exploration, owned the shares of stock in Strata.

8) The testimony from the 1996 Hearing as to the ownership interests of Branko contained the following:

a) On direct examination Mark Murphy stated that he called Mitchell's landman, Smith, and "...informed him that Strata would recommend to its partners that we sell...to Mitchell." (1996 Hearing Tr. p. 19) In responding to the question of what he meant by the word "partner," Murphy said, "...they're a leasehold owner, they own operating rights." (1996 Hearing Tr. p. 20) However, when asked whether Smith ever inquired as to who the partners were, Murphy said: "I think generically he did during the course of conversations, and I've described them as long-term investors of Strata's or people that we've been involved in." (1996 Hearing Tr. p. 23). Murphy stated that Strata was a New Mexico corporation. (1996 Hearing Tr. p. 27) Murphy testified that the arrangement between Strata and the partners was not a formal agreement, and there was no partnership agreement. (1996 Hearing Tr. p. 29) Murphy on several occasions testified that he felt

comfortable negotiating for some of the partners without their specific approval. (1996 Hearing Tr. pp. 37 & 38, 57 & 58)

9) The documentary evidence from the hearings revealed the following regarding the property interest held by Branko:

a) Branko Exhibits No. 1 through 16 are affidavits of the entities comprising Branko. These affidavits state: each entity's undivided interest in the leasehold operating rights or overriding royalty interest in the Lease; all but one of the interests were acquired in 1989, with one affiant stating that its interest was acquired in 1990; and each interest owner states the amount paid for the interest.

b) Branko Exhibit No. 17 is the affidavit of Mark B. Murphy, president of Strata, dated January 17, 1996. The affidavit states that Strata bought the Lease at a federal lease sale in late 1989. Also in late 1989 Strata sold interests in the leasehold operating rights of the Lease to Branko subject to a 1.5% geologic override.

In Paragraph 6 of the affidavit, Murphy states: "Following the sale by Strata of the interest in the Strata North Gavilon Lease as indicated hereinabove in Paragraph 5, **Strata retained all of the record title interest subject to the beneficial interest of the parties as described in Exhibit A hereto."** (Emphasis added.) Exhibit A is the January 13, 1993 letter from Strata to Mitchell that contains Strata's list of "leasehold partners and ownership" some of whom became Branko.

Exhibit B to the affidavit is the federal BLM form titled "Transfer of Operating Rights (Sublease) in a Lease for Oil and Gas or Geothermal Resources" executed by Murphy for Strata on November 7, 1995. It is the transfer of overriding royalty interests. On the first page of Exhibit B at the bottom of the form marked with an asterisk is the following statement: **"Strata owns 100% of the record title interest and leasehold operating rights.** Strata is conveying a 1.5% overriding royalty interest to the parties and in the percentages indicated at Exhibit A hereto. **Strata is retaining 100% of the record title interest and 100% of the leasehold operating rights, subject to the 1.5% overriding royalty interest which is hereby conveyed."** (Emphasis added.)

Exhibit C to the affidavit is the same federal BLM form also executed by Murphy for Strata on November 7, 1995, but this is the transfer of operating rights.

Both Exhibit B and Exhibit C state that the transfer "...shall be effective as of ...November 1, 1989." Neither Exhibit B nor Exhibit C is signed by the transferee.

c) Branko Exhibit No. 23 is a January 1993 letter from Strata to Mitchell. On page 3 of the letter is the statement: "Strata would defend itself and it's [sic] partners [sic] rights during any proceeding including a force pooling hearing."

10) No evidence was presented that Branko had a recordable interest in the Lease until the execution by Murphy for Strata of the BLM transfer forms on November 7, 1995.

D. Conclusions of Law

1) The Commission has jurisdiction over the parties and the subject matter.

2) NMSA 1978, Section 70-2-13 provides, in part, that "[t]he division [OCD] shall promulgate rules and regulations with regard to hearings to be conducted before examiners,...." This section also states that "[i]n the absence of any limiting order, an examiner appointed to hear any particular case shall have the power to regulate all proceedings before him and to perform all acts and take all measures necessary or proper for the efficient and orderly conduct of such hearing." The section concludes with the statement: "When any matter or proceeding is referred to an examiner and a decision is rendered thereon, **any party of record** adversely affected shall have the right to have the matter heard *de novo* before the commission **upon application filed with the division within thirty days from the time any such decision is rendered."** (Emphasis added.)

Rule 1220 of the OCD Rules and Regulations states: "When any order has been entered by the Division pursuant to any hearing held by an Examiner, **any party of record** adversely affected by such order shall have the right to have such matter or proceeding heard *de novo* before the Commission." (Emphasis added.)

NMSA 1978, Section 70-2-25 states, in part: "Within twenty days after entry of any order or decision of the commission, **any party of record** adversely affected thereby may file with the commission an application for rehearing...." (Emphasis added.)

Branko was not a party of record in Case No. 10656 and did not have standing to request the OCD reopen the case or to request the Commission grant Branko a *de novo* hearing pursuant to NMSA 1978, Section 70-2-13 or 70-2-25 or Rule 1220.

However, Rule 1203 of the OCD Rules and Regulations, provides, in part: **"The Division upon its own motion**, the Attorney General on behalf of the State, and

any operator or producer, **or any other person having a property interest may institute proceedings for a hearing."** (Emphasis added.) The Commission concludes that the OCD provided Branko a hearing on May 2, 1996, pursuant to Rule 1203 to determine whether Branko had a property interest affected by Case No. 10656 and Order No. R-9845.

3) NMSA 1978, Section 70-1-1 states: "That all assignments and other instruments of transfer of royalties in the production of oil, gas or other minerals on any land in this state, including lands operated under lease or contract from the United States and from the state of New Mexico, shall be recorded in the office of the county clerk of the county where the lands are situated."

NMSA 1978, Section 70-1-2 states: "Such records shall be notice to all persons of the existence and contents of such assignments and other instruments so recorded from the time of filing the same for record, and no assignment or other instrument of transfer affecting the title to such royalties not recorded as herein provided shall affect the title or right of such royalties of any purchaser or transferee in good faith, without knowledge of the existence of such unrecorded instrument."

No evidence was presented that Branko's interests in the Lease were recorded prior to November 7, 1995; Strata was the record owner of the Lease at the time Mitchell filed the 1992 Application and at the time of the 1993 Hearing.

The Commission concludes that at the time the 1992 Application was filed with the OCD, Branko was not an interest owner entitled to notice pursuant to NMSA 1978, Section 70-2-17 and OCD Rule 1207.

IT IS THEREFORE ORDERED THAT:

(1) Branko's Motion be, and hereby is, denied.

(2) The OCD Order R-9845 issued February 15, 1993, is in full force and effect.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

JAMI BAILEY, Member

WILLIAM W. WEISS, Member

WILLIAM J. LEMAY, Chairman

S E A L

COMPULSORY POOLING IN NEW MEXICO

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COMPULSORY POOLING IN NEW MEXICO

Pooling is the voluntary or compulsory joining of oil and gas interest for common development within a state-established spacing or proration unit. Voluntary pooling is the joinder of oil and gas interest by agreement. Compulsory pooling, on the other hand, is the joinder of oil and gas interests by force of law using the state's police power. Pooling is a necessary incident to the rules regarding well spacing; it is necessary to protect correlative rights and to prevent waste.[1] The Oil and Gas Act provides, *inter alia*, the state's authority for compulsory pooling.[2]

I. DEFINITIONS

When discussing pooling it is helpful to define certain commonly used terms which are often used incorrectly and/or with imprecision. In this regard, we adopt the following definitions in order to facilitate discussion:

> "Communitization" is the pooling of federal, state or indian leases with one another or with fee leases within a state-established spacing or proration unit.
>
> "Correlative Rights" means the opportunity afforded, so far as it is practicable to do so, to the owner of each property in a pool to produce without waste his just and equitable share of the oil or gas or both in the pool, being an amount, so far as can be practicably determined and so far as can be practicably obtained without waste, substantially in the proportion that the quantity of recoverable oil or gas or both under the property bears to the total recoverable oil or gas or both in the pool and, for such purpose, to use his just and equitable share of the reservoir energy.[3]
>
> "Pool" means any underground reservoir containing a common accumulation of crude petroleum oil or natural gas or both. Each zone of a general structure, which zone is completely separated from any other zone in the structure, is a separate pool. Pool is synonymous with "common source of supply" and with "common reservoir."[4]

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1 The prevention of waste and the protection of correlative rights are fundamental to oil and gas conservation practice and policies. In general, compulsory pooling protects correlative rights by insuring that all interest owners have the right to participate, and it prevents economic waste by avoiding the drilling of unnecessary wells.

2 The Oil and Gas Act (also referred to herein as the "Act") is found at § 70-2-1 et seq. NMSA 1978 (1995 Repl.). References in text to sections of the Act will be by section number only.

3 § 70-2-33 H. NMSA 1978 (1995 Repl.)

4 § 70-2-33 B. NMSA 1978 (1995 Repl.)

"Pooling" is the voluntary or compulsory joining of oil and gas interests for common development within a state-established spacing or proration unit.

"Spacing or Proration Unit" is the geographic area prescribed or designated by applicable well spacing regulations for the granting of a permit by the regulatory agency for drilling of a well; the area assigned in the granting of a well permit.[5]

"Unitization" is the joining for common development and unified operation of oil and gas interests covering all or part of the pool or structure as a geologic unit.

"Waste" means physical waste and/or economic waste. Physical waste is the loss of oil or gas that could have been recovered and put to use. Such waste can occur on the surface or underground. An example of waste on the surface is the flaring of gas. An example of underground waste is the inefficient use of reservoir energy. Economic waste is the loss of value in connection with the recovery of oil and gas. Examples of economic waste are the sale of oil or natural gas at too low of a price at the wellhead, and the drilling of unnecessary wells.[6]

II. WELL SPACING

Well spacing refers to the "regulation of the number and location of wells over an oil and gas reservoir, as a conservation measure."[7] The regulation of well spacing came about originally because of problems created by the application of the rule of capture and the resulting inefficiencies.

The Oil and Gas Act specifically empowers the Oil Conservation Division to "fix the spacing of wells."[8] Rule 104 of the Oil Conservation Division Rules and Regulations provides the general statewide rules for well spacing.[9] On a case-by-case basis, the Oil Conservation Division

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5 While there are technically differences between spacing units and proration units, in New Mexico these terms are often used together and/or interchangeably.

6 H. Williams and C. Meyers, Manual of Oil and Gas Terms 1164 (2000). See also §70-2-3 NMSA 1978 (1995 Repl.).

7 H. Williams and C. Meyers, Manual of Oil and Gas Terms 1178 (2000).

8 § 70-2-12 B. (10) NMSA 1978 (1995 Repl.). In addition to this specific authority, the Oil Conservation Division and Oil Conservation Commission have broad general authority.

9 Rule 104 of Oil Conservation Division Rules and Regulations.

and/or the Oil Conservation Commission have adopted special pool rules for certain pools. Pooling of separate interests within a spacing or proration unit, whether by agreement or compulsory pooling, is required in order to protect the correlative rights of all owners within the spacing or proration unit.

III. STATUTORY POOLING PROVISIONS

Section 70-2-17 C. of the Act provides that owners of separate tracts or separate interests, or any combination thereof, which are embraced within a spacing or proration unit may be pooled by the owners and developed as a unit.[10] If the owners cannot reach agreement to pool their interests, and where one or more of the owners has drilled or proposes to drill a well on the spacing and proration unit, the Oil Conservation Division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit.[11] All pooling orders shall be made after notice and hearing, shall be just and reasonable, and shall afford the owners in the unit the opportunity to recover their fair share of the oil and gas.[12] Each pooling order shall describe the lands included in the unit designated thereby, identify the pool or pools to which it applies and designate an operator for the unit.[13]

Section 70-2-17 C. also provides some detail regarding costs and production in a compulsory pooling situation. Regarding costs, the statute requires that the pooling order shall make definite provisions regarding the nonconsenting party's share of costs and the means of recouping such costs.[14] Specifically, the statute provides:

> Such pooling order of the division shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorata reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well.[15]

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10 § 70-2-17 C. NMSA 1978 (1995 Repl.).

11 *Id.*

12 *Id.*

13 *Id.*

14 *Id.*

15 *Id.*

Regarding the allocation of production, the statute provides that production is to be allocated to the respective tracts within the spacing or proration unit on a surface acreage basis.[16] The statute further provides that unleased interests which are subject to compulsory pooling shall be considered as a working interest as to seven-eighths of such interest, and a royalty interest as to one-eighth of such interest.[17]

The Oil and Gas Act makes pooling the obligation of the operator.[18] Specifically, where there are separately owned tracts or interests, or both, within a spacing or proration unit, Section 70-2-18 A. requires the operator "to obtain voluntary agreements pooling said lands or interests or an order of the Division pooling said lands, which agreement or order shall be effective from the first production."[19] Section 70-2-18 B. sets forth the penalty to the operator for failure to pool.[20]

IV. OIL CONSERVATION COMMISSION AND OIL CONSERVATION DIVISION

Section 70-2-4 of the Oil and Gas Act creates the Oil Conservation Commission and provides that it shall be composed of a designee of the Commissioner of Public Lands, a designee of the Secretary of Energy, Minerals and Natural Resources and the Director of the Oil Conservation Division.[21] The members of the Commission shall be persons who have expertise in the regulation of petroleum production.[22] The Director of the Oil Conservation Division is to be appointed by the

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16 *Id.*

17 *Id.*

18 § 70-2-18 A. NMSA 1978 (1995 Repl.).

19 *Id.*

20 § 70-2-18 B. NMSA 1978 (1995 Repl.) provides:

> Any operator failing to obtain voluntary pooling agreements, or failing to apply for an order of the division pooling the lands dedicated to the spacing or proration unit as required by this section, shall nevertheless be liable to account to and pay each owner of minerals or leasehold interest, including owners of overriding royalty interests and other payments out of production, either the amount to which each interest would be entitled if pooling had occurred or the amount to which each interest is entitled in the absence of pooling, whichever is greater. (emphasis added)

Application of the penalty is unclear. Specifically, it is unclear under what circumstances the "amount to which each interest would be entitled if pooling had occurred" would differ from the "amount to which each interest is entitled in the absence of pooling." It appears that one situation might be where unleased minerals are involved. Another situation might be where there are more than one well on the spacing or proration unit and one or more of the wells is uneconomic.

21 § 70-2-4 NMSA 1978 (1995 Repl.).

22 *Id.*

Secretary of Energy, Minerals and Natural Resources.[23] The qualifications of the Director of the Oil Conservation Division are prescribed by Section 70-2-5 B.

The jurisdiction, authority and control of the Oil Conservation Division is broadly stated to cover "all persons, matters or things necessary or proper to enforce effectively the provisions of this Act or any other law of this state relating to the conservation of oil or gas ...."[24] The Oil Conservation Commission is given concurrent jurisdiction and authority with the Oil Conservation Division to the extent necessary to the Commission to perform its duties' as required by law.[25] In addition, Section 70-2-11 empowers and requires the Oil Conservation Commission and the Oil Conservation Division to prevent waste and to protect correlative rights. Finally, Section 70-2-12 identifies various specific powers with which the Oil Conservation Division is vested.

The Oil Conservation Commission and the Oil Conservation Division are given power by the Act to "subpoena witnesses, to require their attendance and giving of testimony before it, and to require the production of books, papers and records in any proceeding before the Commission or the Division."[26] In the case of failure or refusal on the part of any person to comply with any subpoena issued by the Oil Conservation Commission or the Oil Conservation Division, the Commission or the Division may petition any district court in the State to compel compliance with the subpoena.[27] In the case of disobedience of such a subpoena, the court shall have power to punish for contempt.[28] Perjury before the Commission or Division is punishable by imprisonment for not more than five (5) years nor less than six (6) months.[29]

V. REHEARINGS AND APPEALS

In general, hearings are initially conducted by an examiner appointed by the Director of the Oil Conservation Division.[30] Any party adversely affected by an Oil Conservation Division

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23 § 70-2-5 B. NMSA 1978 (1995 Repl.).

24 § 70-2-6 A. NMSA 1978 (1995 Repl.).

25 § 70-2-6 B. NMSA 1978 (1995 Repl.).

26 § 70-2-8 NMSA 1978 (1995 Repl.).

27 § 70-2-9 NMSA 1978 (1995 Repl.).

28 *Id.*

29 § 70-2-10 NMSA 1978 (1995 Repl.).

30 § 70-2-13 NMSA 1978 (1995 Repl.). In the discretion of the Division Director, the Oil Conservation Commission shall initially hear the matter instead. §70-2-6 B. NMSA 1978 (1995 Repl.).

decision shall have the right to have the matter heard de novo before the Oil Conservation Commission upon application filed with the Oil Conservation Division within thirty (30) days from the time any such decision is rendered.[31]

Any party of record adversely affected by an order or decision of the Oil Conservation Commission may, within twenty (20) days after entry of such order or decision, file an application with the Commission for rehearing.[32] The Commission shall grant or refuse such application within ten (10) days after the application is filed.[33] The failure of the Commission to act on an application for rehearing shall be deemed a refusal and final disposition of such application.[34] A party dissatisfied with the disposition of the application for rehearing may appeal to the District Court pursuant to the provisions of Section 39-3-1.1 NMSA 1978.[35] A party dissatisfied with the District Court Decision may file a Petition for Writ of Certiorari with the Court of Appeals, and a further review by filing a Petition for Writ of Certiorari with the Supreme Court.[36]

VI. NOTICE REQUIREMENTS --THE *UHDEN* CASE

The Act provides that the Oil Conservation Division "shall prescribe by rule its rules of order or procedure in hearings or other proceedings before it ...."[37] The Oil Conservation Division rules of procedure are set forth at Section N of the Oil Conservation Division rules and regulations which provide, *inter alia*, rules and procedures regarding notice of hearings in general and specific rules and procedures regarding compulsory pooling hearings.

The Oil Conservation Division rules of procedure provide for notice by publication[38] and actual notice.[39] In connection with applications for compulsory pooling, Rule 1207.A.(l)(a) provides:

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31 § 70-2-13 NMSA 1978 (1995 Repl.).

32 § 70-2-25 A. NMSA 1978 (1995 Repl.).

33 *Id.*

34 *Id.*

35 § 70-2-25 B. NMSA 1978 (2000 Cum. Supp.).

36 § 39-3-1.1 NMSA 1978. Under the prior rules, the Judgment or Decision of the District Court could be appealed to the Supreme Court with a right to have the Court review the case. See § 70-2-25 B. NMSA 1978 (1995 Repl.).

37 § 70-2-7 NMSA 1978 (1995 Repl.).

38 Rules 1204 and 1205 of Oil Conservation Division Rules and Regulations.

39 Rule 1207 of Oil Conservation Division Rules and Regulations.

(a) Notice shall be given to any owner of an interest in the mineral estate whose interest is evidenced by a written document of conveyance either of record or known to the applicant at the time of filing the application and whose interest has not been voluntarily committed to the area proposed to be pooled or unitized (other than a royalty interest subject to a pooling or unitization clause). [40]

The rules under Rule 1207 also identify the time for providing notice[41] and proof that notice has been provided.[42] Also, and importantly for purposes of applications regarding compulsory pooling, Rule 1207.D. provides that "[e]vidence of failure to provide notice as provided in this rule may, upon a proper showing, be considered cause for reopening the case."[43]

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40 Rule 1207. A.(1)(a) of Oil Conservation Division Rules and Regulations. The prior rule regarding notice under Rule 1207.A.(1) provides as follows:

> Actual notice shall be given to each known individual owning an uncommitted leasehold interests, an unleased and uncommitted mineral interest, or royalty interest not subject to a pooling or unitization clause in the lands affected by such application which interest must be committed and has not been voluntarily committed to the area proposed to be pooled or unitized. Such individual notice in compulsory pooling or statutory unitization cases shall be by certified mail (return receipt requested).

41 Rule 1207. B. of Oil Conservation Division Rules and Regulations which provides:

> Any notice required by this rule shall be to the last known address of the party to whom notice is to be given at least 20 days prior to the date of hearing of the application and shall apprise such party of the nature and pendency of such action and the means by which protests may be made.

42 Rule 1207.C. of the Oil Conservation Division Rules and Regulations which provides:

> At each hearing, the applicant shall make a record, either by testimony or affidavit signed by the applicant or its authorized representative, that : (a) the notice provisions of this Rule have been complied with; (b) the applicant has conducted a good-faith diligent effort to find the correct address of all persons entitled to notice; and (c) pursuant to this Rule, notice has been given at that correct address as required by this rule. In addition, the record shall contain the name and address of each person to whom notice was sent and, where proof of receipt is available, a copy of the proof.

43 Rule 1207.D. of the Oil Conservation Division Rules and Regulations. This is important for various reasons including the risk penalty which may be assessed in compulsory pooling cases pursuant to §70-2-17 C. NMSA 1978 (1995 Repl.). In this regard, failure to give proper notice may give the aggrieved party an opportunity to participate without risk and without a risk penalty. Also, it may reopen other issues which the applicant thought had been resolved.

The case of *Uhden v. New Mexico Oil Conservation Commission*[44] provides some indication of the pitfalls which may result from the failure to provide adequate notice to parties with a constitutionally protected property interest. In *Uhden*, the issues presented were (1) whether the proceeding was adjudicatory or rulemaking, and (2) whether the royalty interests reserved by the lessor of an oil and gas estate were materially affected by a state proceeding so as to entitle the lessor to actual notice of the proceeding.[45] The court in *Uhden* held that the proceeding was adjudicatory and that the lessor, Ms. Uhden, was entitled to notice and an opportunity to be heard under the due process requirements of the New Mexico and United States Constitutions.[46]

In reaching its decision, the *Uhden* court noted that Ms. Uhden' s royalty interest was a constitutionally protected property interest which was not diminished by her lessor/lessee relationship with Amoco or the pooling provision in her lease to Amoco. After determining that Ms. Uhden' s right was constitutionally protected, the *Uhden* court found that due process was required.[47] Specifically, the *Uhden* court found that notice and an opportunity to be heard were fundamental to due process.[48] In *Uhden*, the court cited various cases and adopted the rule that parties with constitutionally protected rights are entitled to actual notice of proceedings which may affect such rights when "the identity and whereabouts of the person entitled to notice are reasonably ascertainable."[49] Specifically, the *Uhden* court held:

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44 *Uhden v. New Mexico Oil Conservation Commission*, 112 N.M. 528 (1991).

45 *Id* at 529.

46 *Id.*

47 *Id.* at 530.

48 *Id.* Regarding due process, the Uhden court noted:

> "In *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 70 S.Ct. 652, 94 L.Ed. 865 (1950), the United States Supreme Court stated that "[a]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." 339 U.S. at 314,70 S.Ct. at 657. The Court also said that " [b]ut when notice is a person' s due, process which is a mere gesture is not due process. The means employed must be such as one desirous of actually informing the absentee might reasonably adopt to accomplish it." *Id.* at 315, 70 S.Ct. at 657. Significantly, the Court refused to sanction notice by publication to those whose identity and whereabouts were ascertainable from sources at hand."

Id.

49 *Id.* at 531.

> Uhden's identity and whereabouts were known to Amoco, the party who filed the spacing application. On these facts, we hold that if a party's identity and whereabouts are known or could be ascertained through due diligence, the due process clause of the New Mexico and United States Constitutions requires the party who filed a spacing application to provide notice of the pending proceeding by personal service to such parties whose property rights may be affected as a result.[50]

The case of *Johnson v. New Mexico Oil Conservation Commission*[51] is another New Mexico Supreme Court case where the Court held that the Oil Conservation Commission's Order was invalid on notice grounds. The *Johnson* case involved the Commission's modification of Oil and Gas Rule 104 regarding the spacing of wildcat gas wells.[52] In the *Johnson* case, the Supreme Court held that the Oil Conservation Commission had not followed its own Rules regarding notice and, therefore, it was not necessary to address the Federal and State constitutional due process issues.[53]

After *Uhden*, the most critical aspect of compulsory pooling has become the notification of all interested parties and an opportunity to be heard. Based on *Uhden*, the failure to provide adequate notice and an opportunity to be heard in a compulsory pooling case may result in the affected interest owners being afforded an opportunity to reopen the case in general and, *inter alia*, to participate in the affected well without risk and without the risk penalty which is otherwise generally allowed by the Oil Conservation Division.

VII. SPECIAL ISSUES

A. POOLING OF MULTIPLE FORMATIONS

In general, the applicant in a compulsory pooling proceeding should pool all formations from the surface down to the deepest depth drilled. This requires that the applicant understand the possible producing formations and the spacing or proration units for each of such formations. The pooling of multiple formations presents special issues which do not exist when only one formation is involved. One issue is whether the interest owners being pooled should have multiple options regarding participation in the proposed operations.[54] A related issue is how to handle the situation

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50 *Id.*

51 *Johnson v. New Mexico Oil Conservation Commission*, 127 N.M. 120 (1999).

52 *Id.* at 121.

53 *Id.* at 125.

54 See *Viking Petroleum, Inc. v. Oil Conservation Commission*, 100 N.M. 451 (1983); and Terrell, Spacing, Force Pooling, and Exception Locations, Rocky Mountain Mineral Law Special Institute on Oil and Gas Conservation Law and Practice, 10-1, 10-44 through 46 (Rocky Mountain Mineral Law Foundation 1985).

where there has been a horizontal segregation. Another issue is how the multiple formations may affect the allocation of costs and the assessment of a risk penalty.

B. EXCESSIVE LEASE BURDENS

Non-cost bearing burdens on production obviously affect the economic viability and limits of oil and gas operations. When such burdens on production are excessive, they may frustrate oil and gas operations all together. The problem of excessive burdens can be exacerbated in compulsory pooling situations because participating parties must bear such burdens and the nonconsenting parties back-in for their interest after costs and the risk penalty are recovered. Since the participating parties generally bear the non-cost bearing burdens, parties that anticipate compulsory pooling of their interests may want to consider carving out or conveying a non-cost bearing burden prior to compulsory pooling. In this way the parties being pooled can enhance their position.

VIII. PRESENTING A COMPULSORY POOLING CASE

The first step in a compulsory pooling case is the filing of an application with the Oil Conservation Division. The application briefly describes the applicant's proposed operations, the spacing and proration unit to be dedicated to the proposed well, the formations and interests to be pooled, the status of the pooling efforts, and the agency action requested. The Oil Conservation Division provides notice by publication[55] and the applicant is responsible for providing the actual notice to the interested parties.[56] The parties appearing before the Oil Conservation Division and/or the Oil Conservation Commission are required to file a Pre-Hearing Statement three days in advance of a scheduled hearing.[57] The Pre-Hearing Statement must include: "the names of the parties and their attorneys; a concise statement of the case; the names of all witnesses the party will call to testify at the hearing; the approximate time the party will need to present its case; and identification of any procedural matters that are to be resolved prior to the hearing."[58]

In general, the applicant in a compulsory pooling case should provide evidence regarding each of the following:

(1) The spacing unit(s) to be pooled;

(2) The nature and percentage of the ownership interests in the spacing unit(s) to be pooled and location and depth of the proposed well;

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55 Rules 1204 and 1205 of the Oil Conservation Division Rules and Regulations.

56 Rule 1207 of the Oil Conservation Division Rules and Regulations.

57 Rule 1208.B.

58 *Id.*

(3) The name and last known address of all parties to be pooled and the nature and percent of their interest;

(4) The name of the formations and/or pools to be pooled;

(5) Whether the pooled unit is for gas and/or oil production as appropriate;

(6) Attempts made to gain voluntary agreement including but not limited to copies of appropriate correspondence;

(7) Geological map(s) of the fonnation(s) to be tested and a geological and/or engineering assessment of the risk involved in the drilling of the well and a proposed risk penalty to be assessed against any owner who chooses not to pay his share of estimated well costs;

(8) Proposed overhead charges to be applied during drilling and production operations and the reasonableness of such proposed charges; and

(9) The AFE to be submitted to the interest owners in the well.[59]

In general, the evidence provided at the hearing is both by testimony and exhibits. The witnesses required to provide the above-described evidence are generally landmen, geologists and engineers, or some combination of the three. Parties in opposition to an application for compulsory pooling will present appropriate evidence in suppon of their position. The evidence presented will, of course, depend on the nature of the opposition.

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59 This evidence is set folth at Rule 1207.A.(1)(b) which provides for an alternative procedure when the application for compulsory pooling is known to be unopposed. The alternative procedure contemplates that such evidence shall be included in an application when no opposition is expected. Although not stated in the rules, the evidence required in connection with an unopposed application is basically the same as the evidence needed when the application is opposed.

Formulating the Pooling Case/ Hypothetical Case/ Presenting the Case to the Oil Conservation Division

I. Formulating the Pooling Case

Developing the Case -- Asking the Right Questions

→ What are the objectives --

→ Oil, gas, oil and gas

→ Depth/age of primary and secondary objectives

→ Size of possible spacing or proration units

→ Where is the well to be located?

→ Is there flexibility? If so, you may be able to do some planning regarding the 320 acre spacing units -- stand up or lay down. Is the proposed location orthodox?

→ Are there special pool rules?

→ If there are special pool rules, then you need to refer to the special pool rules. If there are no special pool rules, then you base your decisions on the general state-wide rules.

→ What is the land situation for the relevant areas?

→ This question assumes that you have already identified the relevant areas.

→ It is important that you properly identify all interest owners. At some point you will want a drilling title opinion -- this should be done as part of the pooling process.

II. Hypothetical Case

The 3-D No. 1 Well

→ What are the objectives --

→ Primary objective is devonian (40 acres)

→ Secondary objectives -- Morrow Gas (320 acres)
Atoka Gas (320 acres)
Wolfcamp Oil or Gas (40 or 320 acres)
Bone Springs Oil or Gas (40 or 160 acres)
Delaware Oil (40 Acres)

→ What does this tell us? We should pool based on 40, 160 and 320 acre spacing units.

Unleased --

→ An undivided 10% of the SW/4 and the NE/4 are unleased. These unleased minerals are owned by missing party. This interest must be pooled by compulsory pooling. 7/8 will be treated as working interest and 1/8 will be treated as royalty interest.

III. PRESENTING A COMPULSORY POOLING CASE TO THE OCD

(1) Elements of the Case

a. What is the applicant seeking?

b. Land issues:

(i) Ownership

(ii) Voluntary agreements

(iii) Notice

(iv) Operating Agreement -- Overhead rates

(v) Other issues

c. Geologic/Engineering Issues

(i) Merits of project

(ii) Risk of project

(iii) Prevention of Waste/Protection of Correlative Rights

(2) Witnesses and Exhibits

a. Landman

(i) Ownership information and status of interest

(ii) Attempts to obtain voluntary agreements

(iii) Notice -- Return receipts and affidavit

(iv) AFE and Operating Agreement

b. Geologic/Engineering Issues

(i) Well proposal and prognosis

(ii) Cross sections

(iii) Production maps

(iv) Structure maps

(3) Pitfalls

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→ Where is the well to be located? 1980 FSL and 1980 FWL. Maximum flexibility. This is an orthodox location for all intervals.

→ Are there special pool rules? No. Therefore, you apply general state-wide rules.

→ What is the land situation for the relevant areas?

Land Situation Regarding 3-D No. 1 Well

→ Parties

A Company
B Company
C Company
D Company
E Company
Missing Party
Pooling Party

→ Leases and Ownership

Lease 1 --

→ Federal lease covering NW/4 and N/2SE/4

→ Companies A, B, C, D and E each own an undivided 20% in this lease.

→ No pooling agreement.

→ Communitization agreement necessary.

Lease 2 --

→ Fee lease covering an undivided 50% of the SW/4 and NE/4.

→ Pooling party owns this lease.

→ Lease has standard pooling provision.

Lease 3 --

→ Fee lease covering an undivided 40% of SW/4 and NE/4.

→ A Company owns this lease.

→ Lease has standard pooling provision.

Lease 4 --

→ State lease covering S/2SE/4.

→ B Company owns this lease.

→ Communitization agreement necessary.

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KRAMERT 914-A BOX 800 TULSA, OK 74101
SECTION PLAT
Scale: 1 inch = 660 feet
Printed in U.S.A.

SECTION _____ TOWNSHIP _____ RANGE _____ COUNTY _____ STATE _____

Lse 1 (Fed) A, B, C, D & E	1	Lse 2 (50%) Pooling Party Lse 3 (40%) A Company Unleased (10%) Missing Party	2, 3 & UL
1	1	2, 3 & UL	2, 3 & UL
2, 3 & UL	2, 3 & UL "3-D No. 1"	1	1
2, 3 & UL	2, 3 & UL	Lse 4 (State) B Company	4

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STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 7922
Order No. R-7335

APPLICATION OF RIO PECOS CORPORATION INC. FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 9 a.m. on July 20, 1983, at Santa Fe, New Mexico, before Examiner Richard L. Stamets.

NOW, on this 22nd day of August, 1983, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS:

(1) That due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) That the applicant, Rio Pecos Corporation, Inc., seeks an order pooling all mineral interests in the Wolfcamp and Pennsylvanian formations underlying the N/2 of Section 2, Township 18 South, Range 28 East, NMPM, Eddy County, New Mexico.

(3) That the applicant has the right to drill and proposes to drill a well at a standard location thereon.

(4) That there are interest owners in the proposed proration unit who have not agreed to pool their interests.

(5) That the evidence establishes that after receiving notice of the subject compulsory pooling application, Ralph Nix and Loneta Curtis created a 50 percent overriding royalties burden on their interest to Ralph Nix, Jr. and Sarah Garretson, their son and daughter, respectively, in the NE/4 NW/4 of said Section 2.

(6) That the evidence presented established that all other working interest owners in the N/2 of said Section 2 had voluntarily agreed to a 6.25 percent overriding royalty interest.

(7) That the evidence established that a reasonable overriding royalty interest in this proration and spacing unit would be not in excess of 12.5 percent.

(8) That for each $800.00 of income attributable to a well which might be drilled and completed on the N/2 of said Section 2 under terms of this order, the operator would receive, exclusive of expenses and taxes, $37.50 attributable to the NE/4 NW/4.

(9) That as to any comparable 40-acre tract comprising the N/2 of said Section 2, the operator would receive $81.25.

(10) That if the owners in the NE/4 NW/4 of said Section 2 proved to be non-consenting participants in the proposed well, the payout period for their interest in well costs would be 76 percent longer than for comparable interests in other tracts in the N/2 of said section.

(11) That it would not be just and reasonable to require the owners of participating interests in the proposed proration and spacing unit to bear extra costs and risks associated with well cost payout requiring 76 percent more time than others in the unit.

(12) That the smaller share of operating income attributable to the NE/4 NW/4 of said Section 2 could result in operating expenses exceeding operating income as to said tract while the rest of the unit was being operated profitably.

(13) That compulsorily pooling the proposed proration unit under such conditions would not be just or reasonable.

(14) That to compulsorily pool the entire N/2 of said Section 2 would cause the operator of the well to bear an unreasonable, and therefore unnecessary, cost burden as to that portion of the proration unit bearing said 50 percent overriding royalty.

(15) That in order to protect correlative rights, prevent waste, and to avoid compulsory pooling under terms that are not just or reasonable, any compulsory pooling order issuing in this case should provide for voluntary reduction of the overriding royalty for the NE/4 NW/4 to a reasonable figure,

within a reasonable time, or for the pooling of the N/2 of said Section 2 exclusive of the NE/4 NW/4.

(16) That, subject to conditions contained in Finding No. (15) above, to avoid the drilling of unnecessary wells, to protect correlative rights, and to afford to the owner of each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the gas in any Wolfcamp or Pennsylvanian Pool lying under the proposed proration unit, the subject application should be approved by pooling all mineral interests, whatever they may be, within said unit.

(17) That as requested by the applicant, Costa Resources, Inc., should be designated the operator of the subject well and unit.

(18) That any non-consenting working interest owner should be afforded the opportunity to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production.

(19) That any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his share of the reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

(20) That any non-consenting interest owner should be afforded the opportunity to object to the actual well costs but that actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(21) That following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(22) That $4,000.00 per month while drilling and $400.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); that the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are

reasonable, attributable to each non-consenting working interest.

(23) That all proceeds from production from the subject well which are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(24) That upon the failure of the operator of said pooled unit to commence drilling of the well to which said unit is dedicated on or before December 1, 1983, the order pooling said unit should become null and void and of no effect whatsoever.

IT IS THEREFORE ORDERED:

(1) That all mineral interests, whatever they may be, in the Wolfcamp and Pennsylvanian formations underlying the N/2 of Section 2, Township 18 South, Range 28 East, NMPM, Eddy County, New Mexico, are hereby pooled to form a standard 320-acre gas spacing and proration unit to be dedicated to a well to be drilled at a standard location thereon.

PROVIDED HOWEVER, that the operator of said unit shall commence the drilling of said well on or before the 1st day of December, 1983, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Wolfcamp and Pennsylvanian formations;

PROVIDED FURTHER, that in the event said operator does not commence the drilling of said well on or before the 1st day of December, 1983, Order (1) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER, that should said well not be drilled to completion, or abandonment, within 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Order (1) of this order should not be rescinded.

(2) That Costa Resources Inc. is hereby designated the operator of the subject well and unit.

(3) That after the effective date of this order and within 90 days prior to commencing said well, the operator shall furnish to the Division; Ralph Nix, Loneta Curtis, Ralph Nix, Jr., and Sarah Garretson, and any other known working interest owner an itemized schedule of estimated well costs.

(4) That within 30 days from the date the schedule of estimated well costs is furnished to Ralph Nix, Jr. and Sarah Garretson, each shall make an election to voluntarily reduce their share of the 50 percent overriding royalty to an overriding royalty not in excess of a total 12.5 percent for their 40 acre lease and that in the event they do not make that election, the NE/4 NW/4 of said Section 2 shall be excluded from the proration and spacing unit and the Division shall automatically approve the unit as a non-standard proration and spacing unit consisting of all of the N/2 of Section 2 except the NE/4 NW/4.

(5) That the operator shall notify the Division of the decision of Ralph Nix, Jr. and Sarah Garretson requesting approval of the non-standard proration unit if said parties chose to not amend their overriding royalty interest.

(6) That within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner participating in the well under terms of this order shall have the right to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and that any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(7) That the operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90 days following completion of the well; that if no objection to the actual well costs is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual well costs shall be the reasonable well costs; provided however, that if there is an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(8) That within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs in advance as provided above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

(9) That the operator is hereby authorized to withhold the following costs and charges from production:

(A) The pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(B) As a charge for the risk involved in the drilling of the well, 200 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(10) That the operator shall distribute said costs and charges withheld from production to the parties who advanced the well costs.

(11) That $4,000.00 per month while drilling and $400.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); that the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(12) That any unsevered mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under the terms of this order.

(13) That any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(14) That all proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Eddy County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; that the operator shall notify the Division of the name and address of said escrow agent within 30 days from the date of first deposit with said escrow agent.

(15) That jurisdiction of this cause is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

JOE D. RAMEY,
Director

S E A L

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

REOPENED
CASE NO. 12601
ORDER NO. R-11573-A

APPLICATION OF BETTIS, BOYLE AND STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

SUN-WEST OIL AND GAS, INC.'S APPLICATION FOR DE NOVO HEARING BEFORE THE NEW MEXICO OIL CONSERVATION COMMISSION

Sun-West Oil and Gas, Inc., a party of record before the New Mexico Oil Conservation Division in Case No. 12601 and adversely affected by Division Order No. R-11573-A entered on September 24, 2001, pursuant to NMSA 1978, § 70-2-13, hereby requests that this matter be heard de novo before the New Mexico Oil Conservation Commission.

Respectfully Submitted,

STRATTON & CAVIN, P.A.

By: _____

Sealy H. Cavin, Jr.
Stephen D. Ingram
40 First Plaza, Suite 610
Albuquerque, NM 87102
(505) 243-5400

Attorneys for Sun-West Oil and Gas, Inc.

I hereby certify that a true and correct copy of the foregoing was served via facsimile and first-class mail to:

William F. Carr
Holland & Hart, LLP and
Campbell & Carr
P.O. Box 2208
Santa Fe, NM 87504-2208

this 22nd day of October, 2001.

By: _____
Stephen D. Ingram

HAROLD D. STRATTON, JR.*†**
SEALY H. CAVIN, JR.†**°
STEPHEN D. INGRAM†
CYNTHIA J. HILL*

* Also Admitted in Oklahoma
† Also Admitted in Texas
** Also Admitted in Colorado
° New Mexico Board of Legal Specialization Recognized Specialist in the Area of Natural Resources - Oil and Gas Law

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MAILING ADDRESS
P.O. BOX 1216
ALBUQUERQUE, NM 87103-1216
STRATCAV@AOL.COM

October 22, 2001

VIA FEDERAL EXPRESS

New Mexico Oil Conservation Division
1220 S. St. Francis Drive
Santa Fe, NM 87505

Re: Reopened Case No. 12601; Order No. R-11573-A

Gentlemen:

Enclosed please find for filing an original and three copies of Sun-West Oil and Gas, Inc.'s Application for De Novo Hearing Before the New Mexico Oil Conservation Commission. Please file same and return an endorsed copy to the above address.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

:dlp

Enclosures

cc: William F. Carr

NEW MEXICO ENERGY, MINERALS and NATURAL RESOURCES DEPARTMENT

GARY E. JOHNSON
Governor
Jennifer A. Salisbury
Cabinet Secretary

Lori Wrotenbery
Director
Oil Conservation Division

October 26, 2001

Sealy H. Cavin, Jr.
Stephen D. Ingram
Stratton & Cavin, P.A.
40 First Plaza, Suite 610
Albuquerque, New Mexico 87102

William F. Carr
Holland & Hart and Campbell & Carr
P.O. Box 2208
Santa Fe, New Mexico 87504

Re: Case No. 12601, Application of Bettis, Boyle and Stovall, *de novo*

Dear Counsel,

The Commission members have requested that copies of each exhibit which is to be offered during the hearing of this matter be provided to the Commission Secretary no later than one week prior to the date set for hearing in this matter. As the matter is now set for hearing on December 14, exhibits should be submitted to Florene Davidson no later than Friday, December 7. If an agreed continuance results in the matter being set in a subsequent month, exhibits should be submitted no later than one week prior to the re-scheduled hearing.

It would also helpful if you could provide a more detailed statement of your positions in the pre-hearing statement than is customary.

The Commission members believe that review of detailed pre-hearing statements and the documentary evidence to be offered will help them to be better prepared for the issues and testimony. As always, if you have any questions, please do not hesitate to give me a call at 476-3451.

Sincerely,

Stephen C. Ross
Assistant General Counsel

Cc: Florene Davidson, Commission Secretary

NEW MEXICO ENERGY, MINERALS and NATURAL RESOURCES DEPARTMENT

GARY E. JOHNSON
Governor
Jennifer A. Salisbury
Cabinet Secretary

Lori Wrotenbery
Director
Oil Conservation Division

November 9, 2001

Via Facsimile and First Class Mail

Sealy H. Cavin, Jr.
Stephen D. Ingram
Stratton & Cavin, P.A.
40 First Plaza, Suite 610
Albuquerque, New Mexico 87102

William F. Carr
Holland & Hart and Campbell & Carr
P.O. Box 2208
Santa Fe, New Mexico 87504

Re: Case No. 12601, Application of Bettis, Boyle and Stovall, *de novo*

Dear Counsel,

Because of scheduling problems, the Commission has rescheduled its December meeting to **December 4**. The Commission members are also available on December 5 should the evidentiary presentations in this case not be completed on December 4

Accordingly, please provide copies of exhibits and your pre-hearing statements to the Commission Secretary no later than Tuesday, November 27.

As always, if you have any questions, please do not hesitate to give me a call at 476-3451.

Sincerely,

Stephen C. Ross
Assistant General Counsel

Cc: Florene Davidson, Commission Secretary

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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 12601 *DE NOVO*
ORDER NO. R-11573-A

APPLICATION OF BETTIS, BOYLE & STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

PRE-HEARING STATEMENT

This pre-hearing statement is submitted by Holland & Hart LLP as required by Oil Conservation Division Rule 1208.B.

APPEARANCES OF PARTIES

APPLICANT:

Bettis, Boyle & Stovall
Attention: C. Mark Maloney
Post Office Box 2627
Roswell, New Mexico 88202-2627
(505) 622.9907

ATTORNEY:

William F. Carr, Esq.
Holland & Hart LLP
Post Office Box 2208
Santa Fe, New Mexico 87504
(505) 988.4421

OPPOSITION:

Sun-West Oil and Gas, Inc.

ATTORNEY:

Sealy H. Cavin, Jr., Esq.
Stephen D. Ingram, Esq.
Stratton & Cavin, P.A.
40 First Plaza, Suite 610
Albuquerque, New Mexico 87102
(505) 243-5400

STATEMENT OF THE CASE

On April 26, 2001 the Oil Conservation Division entered Order No. R-11573 granting the application of Bettis, Boyle & Stovall for the compulsory pooling of all uncommitted mineral interests under Lots 3 and 4 (W/2 SW/4 equivalent) of Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico. This order imposed on non-participating interest owners a 200% charge for risk involved in the drilling of a well on this pooled unit.

At the examiner hearing, Bettis, Boyle & Stovall asked the Division to order that the interest of Sun-West Oil and Gas, Inc. ("Sun-West") be treated as it was on the date the pooling application was filed -- as an unleased mineral interest -- not as it was on the date of the pooling order after Sun-West, with a private contract, had carved out of its interest a large non-cost bearing royalty burden. Order No. R-11573 was silent on this request and Bettis, Boyle & Stovall asked the Division to re-open the case to address this issue.

On September 24, 2001 the Division entered Order No. R-11573-A which found that the interest of Sun West should be treated as an unleased mineral interest.

With this appeal, Sun-West does not challenge the pooling of these lands nor the amount of the risk penalty. Instead, it challenges the Division's determination that Sun-West cannot defeat the Commission's statutory pooling authority with a private contract.

FACTS:

The undisputed facts in this case show that commencing on December 15, 2000, Bettis, Boyle & Stovall attempted to reach a voluntary agreement with Sun-West for the development of the W/2 SW/4 of Section 30. Sun-West owned an unleased 15% undivided mineral interest in this acreage. Since no agreement could be reached on an appropriate royalty burden for the Sun-

West tract, on January 30, 2001, Bettis, Boyle & Stovall filed an application with the Oil Conservation Division seeking an order pooling the W/2 SW/4 of Section 30 for a well to be drilled to test the San Andres and Pennsylvanian formations.

After Sun-West received notice of Bettis, Boyle & Stovall's pooling application, it leased its interest to Gulf Coast Oil and Gas Company ("Gulf Coast"). Gulf Coast and Sun-West have the same directors and representatives and share the same address and telephone number. When Bettis, Boyle & Stovall contacted Gulf Coast about this pooling application, the person who responded was the same person who had previously responded for Sun-West. The Sun-West lease to Gulf Coast contained a royalty rate in excess of the burden which Bettis, Boyle & Stovall had advised Sun-West would make the drilling of the proposed well uneconomic.

A chronology of relevant events which have resulted in this dispute was admitted into evidence at the May 31, 2001 Division hearing as Bettis, Boyle & Stovall Exhibit No. 3. A copy of this exhibit is attached to this Pre-hearing Statement.

ARGUMENT:

Bettis, Boyle & Stovall asserts that the Sun-West lease to Gulf Coast is an attempt by Sun-West through a private contract to avoid the provisions of the Oil and Gas Act and defeat the Oil Conservation Division's a pooling authority.

In carrying out its statutory duties, the Oil and Gas Act confers on the Oil Conservation Commission "...jurisdiction, authority, and control of and over all persons, matters, or things necessary or proper to enforce effectively the provisions of this act or any other law of this state relating to the conservation of oil or gas...."

NMSA 1978 Section 70-2-6. In carrying out its statutory duties, the Commission has been granted broad authority. *See*, Santa Fe Exploration Co. v. Oil Conservation Commission, 114 N.M. 103, 835 P.2d 819 (1992); Continental Oil Company v. Oil Conservation Commission, 70 N.M. 310, 373 P.2d 809 (1962).

The New Mexico Oil and Gas Act authorizes the Oil Conservation Division to pool oil and gas interests where the owners "...have not agreed to pool their interests, and where one such separate owner, or owners,...has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply." This statute also provides that a Division pooling order "...may include a charge for risk...which charge for risk shall not exceed two hundred percent of the non-consenting working interest owner or owner's prorata share of the cost of drilling and completing the well." NMSA 1978 Section 70-2- 17.C.

Although the Oil and Gas Act provides that the owner who pays for the drilling of the well is entitled to all non-participating interest owners share of production from the well "...after payment of royalty as provided in the lease, if any, applicable to each tract or interest...." until the owners who drilled or paid for the drilling have paid the amount due under the pooling order. The Oil and Gas Act also provides that "All orders effecting such pooling shall . . . be upon such terms and conditions as are just and reasonable and will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil and gas, or both." NMSA 1978, Section 70-2-17.C.

The Oil and Gas Act also provides that "If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths or such

interest shall be considered as a working interest and one-eighth shall be considered a royalty interest...." NMSA 1978 Section 70-2-17.C

In the past the Division has been presented by other situations where operators have attempted to create burdens on tracts which are subject to a pooling application.[1] The Division has not permitted private agreements to defeat its pooling orders. See, Order No. R-11573-A, Finding 14.

In answering questions concerning the exercise of its statutory duties, the Commission acts on a case-to-case basis and upon the particular facts of each case. *See*, Viking Petroleum, Inc. v. Oil Conservation Commission, 100 N.M. 451, 672 P.2d 280,284 (1983). The Division reviewed the particular facts of this case and found in Order No. R-11573-A:

> "It would circumvent the purpose of the New Mexico Oil and Gas Act (NMSA 1978 Sections 70-2-1 to 72-2-38, NMSA, as amended) to allow a party owning an unleased mineral interest in the spacing unit at the time said party was served with a compulsory pooling application to avoid the cost recovery and risk charge provisions of the Act by leasing or otherwise burdening or reducing that interest through a transaction with an affiliated entity after the application and notice of hearing are filed with the Division and served on the party." (Finding 13)

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[1] In Case No. 12087, Order No. R-11109, dated November 19, 1998,Nearburg Exploration Company, L.L.C. sought an order pooling certain lands in lea County, New Mexico. The evidence showed that Merit Energy Company has an internal "net profits interest" which might unnecessarily burden Merit's working interest. Since this net profits interest would not be subject to bear any costs of drilling or completing the well nor be subject to the risk penalty imposed by a pooling order, The Division ordered that this net profits interest be liable for its share of the drilling and completion costs ant that it be subject to the risk factor penalty. Order No. R-11109, Findings (7) through (9) , December 11, 1998.

In Case No. 8640, Order No. R-7998, dated August 8, 1985, Caulkins Oil Company obtained an order which required the "voluntary reduction" of the overriding royalty interest which was considered excessive.

> "In order to effect pooling of the subject unit on terms that are just and reasonable under the circumstances of this case, and to allow Applicant the opportunity to recover or receive without unnecessary expense its just and fair share of the oil underlying the subject unit, the interest of Sun-West should be treated as an unleased interest for the purpose of applying the cost recovery and risk charge provisions of Division Order No. R-11573." (Finding 16)

In this appeal, Sun-West challenges these findings of the Division and seeks a new review of the facts of this particular case. Bettis, Boyle & Stovall contends that to permit Sun-West to assign its interest to Gulf Coast, after being notified of Bettis Boyle & Stovall's compulsory pooling application, to carve out a royalty interest for itself in an amount which puts the drilling of the well in jeopardy is nothing more than an attempt by Sun-West to defeat the compulsory pooling power of the Commission through a private contract with an affiliated entity.

Bettis, Boyle & Stovall asks the Commission exercise the powers conferred on it by the Oil and Gas Act in Sections 70-2-11.A and 70-2-17.C quoted above and enter its order directing that the interest of Sun-West shall be treated for the purpose of this pooling order as an unleased mineral interest. Bettis, Boyle & Stovall asks the Commission reject the attempt of Sun-West to carve create new cost free interests in its land after a pooling application has been filed and Commission jurisdiction has attached. It asks the Commission to disallow for the purpose of this pooling order interests which can defeat the Commission's pooling authority. Bettis, Boyle & Stovall asks the Commission to provide for pooling upon terms which are fair and reasonable to all owners in the pooled unit.

The issue presented by this appeal is of importance to the parties. The Commission's decision in this case is also of importance to the oil and gas industry for

it will set the precedent which interest owners will follow in future negotiations and applications to pool spacing units in the State of New Mexico.

PROPOSED EVIDENCE -- PROCEDURAL MATTERS:

Pursuant to agreement between counsel the record will comprise the transcripts and exhibits from the April 19 and May 31, 2001, Oil Conservation Division hearings in Case No. 12601. No additional evidence or testimony will be presented at the December 4,2001 Oil Conservation Commission hearing. Each party requests an opportunity to argue the case to the Commission.

William F. Carr
Attorney for Bettis, Boyle & Stovall

CERTIFICATE OF SERVICE

I certify that on November 27, 2001, I delivered by facsimile and U. S. Mail a copy of this Pre-Hearing Statement to the following counsel of record:

Sealy H. Cavin, Jr., Esq.
Stephen D. Ingram, Esq.
Stratton & Cavin, P.A.
Post Office Box 1216
Albuquerque, New Mexico 87103-1216
(505) 243-5400
(505) 243-1700 (Facsimile)

Stephen C. Ross, Esq.
Assistant General Counsel
Energy, Minerals and Natural Resources Department
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505
(505) 476-3200
(505) 476- 3220 (Facsimile)

William F. Carr

CHRONOLOGY

December 15,2000	Letter to Sun-West Oil & Gas, Inc. from Bettis, Boyle & Stovall proposing to lease its interest for the drilling of a well in the W/2 of Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico.
January 20, 2001	Letter to Sun-West Oil & Gas, Inc. from Bettis, Boyle & Stovall referencing prior conversations and advising that a 25% royalty was unacceptable. Bettis, Boyle & Stovall expressed interest in drilling as soon as possible to take advantage of current high product prices.
January 30, 2001	Application for compulsory pooling filed at Oil Conservation Division by Bettis, Boyle & Stovall.
January 25, 2001	Letter to Bettis, Boyle & Stovall from Sun-West Oil & Gas, Inc. offering to lease for a 25% royalty.
February 6, 2001	Application for compulsory pooling and notice of hearing received by Sun-West Oil & Gas, Inc.
February 15, 2001	Lease by Sun-West Oil & Gas, Inc. to Gulf Coast Oil & Gas Company of Sun-West interest in Spacing units at a 27.5% royalty.
February 20, 2001	Letter to William F. Carr, attorney for Bettis Boyle and Stovall, from Sun-West Oil & Gas, Inc. acknowledging receipt of the application for compulsory pooling and advising that their interest had been leased for a 27.5% royalty.
February 21, 2001	Gulf Coast Oil & Gas Company lease recorded in Lea County, New Mexico.
March 22, 2001	Letter to Gulf Coast Oil & Gas Company from Bettis, Boyle & Stovall offering them an opportunity to join in the well and advising them that Bettis, Boyle & Stovall cannot carry a 27.5% royalty.
March 23, 2001	Telephone from Shane Spear advising Mark Maloney that Sun-West Oil & Gas, Inc. and Gulf Coast Oil & Gas, Company were essentially the same entities.

BEFORE THE OIL CONSERVATION DIVISON
Santa Fe, New Mexico
Case No. 12601 Exhibit No. 3
Submitted by:
Bettis, Boyle & Stovall
Hearing Date: May 31, 2001

HOLLAND & HART LLP
AND
CAMPBELL & CARR
ATTORNEYS AT LAW

DENVER • ASPEN
BOULDER • COLORADO SPRINGS
DENVER TECH CENTER
BILLINGS • BOISE
CHEYENNE • JACKSON HOLE
SALT LAKE CITY • SANTA FE
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November 27, 2001

HAND DELIVERED

Oil Conservation Commission
New Mexico Department of Energy,
Minerals and Natural Resources
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Attention: Florene Davidson

OIL CONSERVATION DIV.
01 NOV 27 PM 5:0

Re: New Mexico Oil Conservation Division Case 12601:
Application of Bettis Boyle & Stovall to re-open compulsory pooling order no. R-11573 to address the appropriate royalty burdens on the well for the purposes of the charge for risk involved in drilling said well, Lea County, New Mexico.

Dear Ms. Davidson;

Pursuant to Mr. Ross's letter of November 9, 2001 enclosed for filing in the above-referenced case is the Pre-Hearing Statement of Bettis, Boyle & Stovall. The parties have agreed that no new evidence will be presented at the December 4th Oil Conservation Commission hearing and that the record should consist of the transcript and exhibits presented at the April 19, 2001 and May 31, 2001 examiner hearings in this case.

By copy of this letter, I have provided copies of this Pre-Hearing Statement to Commissioners Lori Wrotenbery, Jamie Bailey, and Robert Lee and to Sealy H. Cavin, Esq., and Stephen D. Ingram, Esq. attorneys for Sun-West Oil and Gas, Inc.

Very truly yours,

William F. Carr
Attorney for Bettis, Boyle & Stovall.

Lori Wrotenbery, Chairman
Oil Conservation Commission
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Jami C. Bailey, Commissioner
Oil Conservation Commission
New Mexico State Land Office
310 Old Santa Fe Trail
Santa Fe, New Mexico 87504

Dr. Robert Lee, Commissioner
Oil Conservation Commission
c/o New Mexico Petroleum Recovery Research Center
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Stephen D. Ingram, Esq.
Cavin & Stratton, P.A.
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Mr. C. Mark Maloney
Post Office Box 2627
Roswell, New Mexico 88202-2627

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

REOPENED
CASE NO. 12,601
(DE NOVO)

APPLICATION OF BETTIS, BOYLE & STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

PRE-HEARING STATEMENT

This Pre-Hearing Statement is submitted by Sun-West Oil and Gas, Inc. ("Sun-West") as required by the Oil Conservation Commission.

APPEARANCE OF PARTIES

APPLICANT

Bettis, Boyle & Stovall
P. O. Box 1240
Graham, Texas 76450

ATTORNEY

Holland & Hart, LLP and
Campbell & Carr
William F. Carr
P.O. Box 2208
Santa Fe, NM 87504
Telephone: (505) 988-4421

OPPOSITION OR OTHER PARTY

Sun-West Oil and Gas, Inc.
P.O. Box 1684
Midland, Texas 79702

ATTORNEY

Stratton & Cavin, P.A.
Sealy H. Cavin, Jr.
Stephen D. Ingram
P. O. Box 1216
Albuquerque, NM 87103-1216
Telephone: (505) 243-5400

STATEMENT OF CASE

APPLICANT

Bettis, Boyle & Stovall applied to the Oil Conservation Division to reopen Case No. 12,601 and Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the charge for risk involved in drilling said well. The Division reopened Case No. 12,601 and issued Order No. R-11573-A to provide that the interest owned by Sun-West in the subject unit as of the date of the filing of the original application for compulsory pooling by Bettis, Boyle & Stovall would be treated as an unleased mineral interest for the purpose of applying the cost recovery and risk charge provisions of Order No. R-11573.

OPPOSITION OR OTHER PARTY

Sun-West submits that the Division exceeded its authority in issuing Order No. R-11573-A so as to deem Sun-West's mineral interest as unleased for the purpose of Bettis, Boyle & Stovall's compulsory pooling application. The Division's findings were not supported by substantial evidence, the Division's order was arbitrary and capricious, the Division's order constituted an abuse of discretion, and the Division's order amounted to an unlawful deprivation of protected property interests.

PROPOSED EVIDENCE

APPLICANT

WITNESS	ESTIMATED TIME	EXHIBITS
None	N/A	See Procedural Matters Below

OPPOSITION OR OTHER PARTY

WITNESS	ESTIMATED TIME	EXHIBITS
None	N/A	See Procedural Matters Below

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PROCEDURAL MATTERS

The parties have stipulated that the following will be introduced and admitted into evidence and made part of the record for the Commission hearing:

1. Transcript of the April 19, 2001 hearing in Case No. 12,601 and all exhibits admitted therein;

2. Transcript of the May 31, 2001 hearing in Case No. 12,601 and all exhibits admitted therein;

3. Order No. R-11573;

4. Order No. R-11573-A.

Sun-West may submit its memoranda previously submitted to the Division hearing officer.

RESPECTFULLY SUBMITTED,

STRATTON & CAVIN, P.A.

By: _____

Sealy H. Cavin, Jr.
Stephen D. Ingram
40 First Plaza, Suite 610
Albuquerque, NM 87102
(505) 243-5400

Attorneys for Sun-West Oil and Gas, Inc.

I hereby certify that a true and correct copy of the foregoing pleading was served via facsimile and first-class mail on this 26th day of November, 2001 to the following:

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

William F. Carr
Holland & Hart, LLP and
Campbell & Carr
P.O. Box 2208
Santa Fe, NM 87504-2208

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

REOPENED
CASE NO. 12,601
(DE NOVO)

APPLICATION OF BETTIS, BOYLE & STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

AFFIDAVIT OF SHANE SPEAR

STATE OF NEW MEXICO)
) ss.
COUNTY OF LEA)

Shane Spear, being duly sworn, deposed and stated as follows:

1. My name is Shane Spear. I am over 18 years of age, am fully competent to make this affidavit, and have personal knowledge of the facts stated herein.

2. I am the President of Sun-West Oil & Gas, Inc. and am knowledgeable about the affairs of such corporation. I am also President of Gulf Coast Oil and Gas Company and am knowledgeable about the affairs of such corporation.

3. Sun-West Oil & Gas, Inc. is a subchapter S corporation that was incorporated in the State of Texas on December 9, 1991. Its principal place of business is in Hobbs, New Mexico. It has neither drilled nor operated any wells in New Mexico. It is the standard practice of Sun-West Oil and Gas, Inc. to seek a ¼ royalty when leasing properties.

4. Gulf Coast Oil and Gas Company is a subchapter C corporation that was incorporated in Delaware on November 6, 1980. Its principal place of business is in Midland, Texas. It has neither drilled nor operated wells in New Mexico. Gulf Coast Oil and Gas Company does not utilize a standard royalty rate.

5. I am aware of royalty in the area of at least 30% between entities that are not affiliated with either Sun-West Oil & Gas, Inc. or Gulf Coast Oil and Gas Company.

6. Sun-West Oil & Gas, Inc. and Gulf Coast Oil and Gas Company are separate corporations with differing stock ownerships.

FURTHER AFFIANT SAYETH NAUGHT.

Shane Spear
President, Sun-West Oil and Gas, Inc.

SUBSCRIBED AND SWORN to before me this 6th day of December, 2001, by Shane Spear.

Notary Public

My Commission Expires:

8-1-2002

HAROLD D. STRATTON, JR.*†**
SEALY H. CAVIN, JR.†**°
STEPHEN D. INGRAM†
CYNTHIA J. HILL*

* Also Admitted in Oklahoma
† Also Admitted in Texas
** Also Admitted in Colorado
° New Mexico Board of Legal Specialization Recognized Specialist in the Area of Natural Resources - Oil and Gas Law

STRATTON & CAVIN, P.A.

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STRATCAV@AOL.COM

December 7, 2001

VIA FEDERAL EXPRESS

Florene Davidson, Commission Secretary
New Mexico Energy, Minerals & Natural Resources Department
Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 12,601
Application of Bettis, Boyle & Stovall, *de novo*

Dear Ms. Davidson:

Pursuant to the directive of the Oil Conservation Commission at the December 4, 2001 hearing of this matter, enclosed is an Affidavit of Shane Spear which is submitted on behalf of Sun-West Oil and Gas, Inc. for consideration by the Commission along with the other matters made of record in this proceeding.

Sincerely,

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

SDI:ljc
Enclosure
cc: William F. Carr

NEW MEXICO ENERGY, MINERALS and NATURAL RESOURCES DEPARTMENT

GARY E. JOHNSON
Governor
Jennifer A. Salisbury
Cabinet Secretary

Lori Wrotenbery
Director
Oil Conservation Division

January 3, 2002

Stephen D. Ingram
Stratton & Cavin, P.A.
40 First Plaza, Suite 610
Albuquerque, New Mexico 87102

Re: Case No. 12601, Application of Bettis, Boyle and Stovall, *de novo*

Dear Mr. Ingram,

During the hearing in this matter, in response to questions from Commissioner Bailey, you promised to submit additional information concerning the relationship of Sun-West and Gulf Coast, their experience drilling and operating wells in the immediate area of the subject well, and what both entities charge and receive as royalty payments. You promised to deliver that information over an affidavit by December 10.

I have just had occasion to review the file, and I see no indication that you ever submitted anything. If this is true, I would appreciate a letter of explanation.

As always, if you have any questions, please do not hesitate to give me a call at 476-3451.

Sincerely,

Stephen C. Ross
Assistant General Counsel

Cc: Florene Davidson, Commission Secretary

William F. Carr
Holland & Hart and Campbell & Carr
P.O. Box 2208
Santa Fe, New Mexico 87504

00 081

HAROLD D. STRATTON, JR.*†**
SEALY H. CAVIN, JR.†**°
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CYNTHIA J. HILL*

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January 7, 2002

Stephen C. Ross
Assistant General Counsel
New Mexico Energy, Minerals and
Natural Resources Department
Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 12,601
Application of Bettis, Boyle & Stovall, *de novo*

Dear Mr. Ross:

In response to your January 3, 2002 letter, we submitted the Affidavit of Shane Spear to the Commission in response to questions from Commissioner Jami Bailey on December 7, 2001. Mr. Spear's Affidavit provided the information requested by Ms. Bailey as described in your January 3, 2002 letter. I do not know why this Affidavit did not appear in the file regarding this matter at the time you reviewed it. For your information, enclosed is another copy of the Shane Spear Affidavit and the transmittal letter that accompanied it. If you have any questions, or need any further information, please do not hesitate to call me. Thank you for your consideration.

Sincerely,

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

SDI:ljc
cc: Florene Davidson, Commission Secretary
William F. Carr

HAROLD D. STRATTON, JR.*†**
SEALY H. CAVIN, JR.†***
STEPHEN D. INGRAM†
CYNTHIA J. HILL*

* Also Admitted in Oklahoma
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December 7, 2001

VIA FEDERAL EXPRESS

Florene Davidson, Commission Secretary
New Mexico Energy, Minerals & Natural Resources Department
Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 12,601
Application of Bettis, Boyle & Stovall, *de novo*

Dear Ms. Davidson:

Pursuant to the directive of the Oil Conservation Commission at the December 4, 2001 hearing of this matter, enclosed is an Affidavit of Shane Spear which is submitted on behalf of Sun-West Oil and Gas, Inc. for consideration by the Commission along with the other matters made of record in this proceeding.

Sincerely,

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

SDI:ljc
Enclosure
cc: William F. Carr

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

REOPENED CASE NO. 12,601 (DE NOVO)

APPLICATION OF BETTIS, BOYLE & STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

AFFIDAVIT OF SHANE SPEAR

STATE OF NEW MEXICO)
) ss.
COUNTY OF LEA)

Shane Spear, being duly sworn, deposed and stated as follows:

1. My name is Shane Spear. I am over 18 years of age, am fully competent to make this affidavit, and have personal knowledge of the facts stated herein.

2. I am the President of Sun-West Oil & Gas, Inc. and am knowledgeable about the affairs of such corporation. I am also President of Gulf Coast Oil and Gas Company and am knowledgeable about the affairs of such corporation.

3. Sun-West Oil & Gas, Inc. is a subchapter S corporation that was incorporated in the State of Texas on December 9, 1991. Its principal place of business is in Hobbs, New Mexico. It has neither drilled nor operated any wells in New Mexico. It is the standard practice of Sun-West Oil and Gas, Inc. to seek a ¼ royalty when leasing properties.

4. Gulf Coast Oil and Gas Company is a subchapter C corporation that was incorporated in Delaware on November 6, 1980. Its principal place of business is in Midland, Texas. It has neither drilled nor operated wells in New Mexico. Gulf Coast Oil and Gas Company does not utilize a standard royalty rate.

5. I am aware of royalty in the area of at least 30% between entities that are not affiliated with either Sun-West Oil & Gas, Inc. or Gulf Coast Oil and Gas Company.

6. Sun-West Oil & Gas, Inc. and Gulf Coast Oil and Gas Company are separate corporations with differing stock ownerships.

FURTHER AFFIANT SAYETH NAUGHT.

Shane Spear
President, Sun-West Oil and Gas, Inc.

SUBSCRIBED AND SWORN to before me this 6th day of December, 2001, by Shane Spear.

Notary Public

My Commission Expires:

8-1-2002

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

REOPENED
CASE NO. 12,601
(DE NOVO)

APPLICATION OF BETTIS, BOYLE & STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

APPLICATION FOR REHEARING

Sun-West Oil and Gas, Inc. ("Sun-West"), in accordance with NMSA 1978, § 70-2-25(A), applies to the Oil Conservation Commission for a rehearing as to those matters determined by the Commission in its February 15, 2002 Order No. R-11573-B issued in this matter. The Commission's Order affirms Order No. R-11573-A of the Oil Conservation Division, and the Commission's Order is believed to be erroneous for the reasons set forth in Sun-West's Prehearing Statement filed with the Commission and Sun-West's Hearing Memorandum and Response to Applicant's Hearing Memorandum filed with the Oil Conservation Division, which was incorporated as part of the record before the Commission. Additionally, the Commission's Order is believed to be erroneous for the following reasons:

1. The Commission's finding that Sun-West and Gulf Coast Oil and Gas Company ("Gulf Coast") are affiliates is not supported by substantial evidence.

2. The Commission's finding that Sun-West's non-cost-bearing interest is so large as to render the proposed McGuffin "C" Well No. 1 uneconomic and prevent drilling of the well is not supported by substantial evidence.

3. The Commission's finding that Sun-West's leasing of its mineral interest to Gulf Coast violated the correlative rights of other interest owners is not supported by substantial evidence.

4. The Commission's finding that Sun-West's lease to Gulf Coast was intended to circumvent the Division's pooling authority is not supported by substantial evidence.

5. The Commission's finding that the interest of Sun-West shall be treated as an unleased mineral interest for the purpose of Bettis, Boyle & Stovall's pooling application is not in accordance with law.

6. The Commission's authority to regulate matters relating to conservation of oil and gas production as set forth in NMSA 1978, § 70-2-6 does not authorize the treating of Sun-West's mineral interest as unleased.

7. The Commission exceeded its authority in determining title to property, and thus did not act in accordance with law.

8. The Commission failed to provide Sun-West with the opportunity to recover its just and equitable share of oil and gas produced in accordance with NMSA 1978, § 70-2-17(A), and thus did not act in accordance with law.

9. The Commission did not act in accordance with law by retroactively declaring a validly created royalty interest to not exist through the purported exercise of its pooling authority.

10. The Commission improperly exercised its police power to abrogate a private contract by declaring a vested property interest to be a nullity, and thus did not act in accordance with law.

11. The Commission did not act in accordance with law in declaring Sun-West's interest to be unleased, which constituted a deprivation of property interests without just compensation and without due process of law.

12. The Commission did not act in accordance with law in fixing Sun-West's interest as of the time of Bettis, Boyle & Stovall's pooling application when the Commission's pooling order is not effective until actual production.

13. The Commission's finding that Sun-West's reservation of a non-cost-bearing interest in its lease to Gulf Coast constituted proper circumstances to justify the Commission treating Sun-West's mineral interest as unleased for the purpose of Bettis, Boyle & Stovall's pooling application is arbitrary, as there is no standard set by the Commission as to when such circumstances exist to justify such a remedy.

14. The Commission's finding that Sun-West's actions were done to circumvent the authority of the Commission based on the submission of a seminar article authored by one of Sun-West's attorneys is unwarranted and arbitrary.

15. Even if the deeming of Sun-West's interest as unleased is determined to be within the statutory grant of authority to the Commission, the Commission arbitrarily exercised such authority in this case.

16. The Commission acted arbitrarily in not considering the option of offering an election to Sun-West to voluntarily reduce its royalty interest as the Commission has done in

other cases before ordering the drastic remedy of treating Sun-West's mineral interest as unleased.

WHEREFORE, Sun-West Oil & Gas, Inc. requests that the Commission rehear this matter, and upon such rehearing, that the Commission reverse Order No. R-11573-A of the Oil Conservation Division below from which Sun-West Oil & Gas, Inc. appealed to the Commission.

RESPECTFULLY SUBMITTED,

STRATTON & CAVIN, P.A.

By: _____
Sealy H. Cavin, Jr.
Stephen D. Ingram
40 First Plaza, Suite 610
Albuquerque, NM 87102
(505) 243-5400

Attorneys for Sun-West Oil and Gas, Inc.

I hereby certify that a true and correct copy of the foregoing pleading was served via first-class mail on this 4th day of March, 2002 to the following:

William F. Carr
Holland & Hart, LLP
P.O. Box 2208
Santa Fe, NM 87504-2208

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

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March 4, 2002

VIA FEDERAL EXPRESS

Florene Davidson, Commission Secretary
New Mexico Energy, Minerals & Natural Resources Department
Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 12,601
Application of Bettis, Boyle & Stovall, *de novo*

Dear Ms. Davidson:

Enclosed is an original and 5 copies of Sun-West Oil and Gas, Inc.'s Application for Rehearing. Please contact the undersigned if you have any questions or need any further information.

Sincerely,

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

SDI:ljc
cc: William F. Carr

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APR 12 2002

ENDORSED
First Judicial District Court

APR 10 2002

Santa Fe, Rio Arriba &
Los Alamos Counties
PO Box 2268
Santa Fe, NM 87504-2268

STATE OF NEW MEXICO
COUNTY OF SANTA FE
FIRST JUDICIAL DISTRICT

SUN-WEST OIL AND GAS, INC.,

Appellant,

No. D-0101-CV-200200752

v.

NEW MEXICO OIL CONSERVATION COMMISSION, and BETTIS, BOYLE & STOVALL,

Appellees.

NOTICE OF APPEAL

Sun-West Oil and Gas, Inc. hereby gives notice of its intent to appeal to the District Court the February 15, 2002 Order No. R-11573-B entered in Case No. 12,601 (*de novo*) under the authority of NMSA 1978, § 7-2-25 and NMSA 1978, § 39-3.1.1. This appeal is taken against the New Mexico Oil Conservation Commission and Bettis, Boyle & Stovall. A copy of the Order of the New Mexico Oil Conservation Commission appealed from is attached as Exhibit "A" to this Notice of Appeal.

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RESPECTFULLY SUBMITTED,

STRATTON & CAVIN, P.A.

By: _____

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Albuquerque, New Mexico 87102
(505) 243-5400

ATTORNEYS FOR SUN-WEST OIL AND GAS, INC.

00 000

Pursuant to Rule 74, NMRA 2002,
I hereby certify that a true and correct
copy of the foregoing was served via
first class mail to:

New Mexico Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

William F. Carr
Holland & Hart
PO Box 2208
Santa Fe, New Mexico 87501-2208

this 9th day of April, 2002.

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 12601

THE APPLICATION OF BETTIS, BOYLE AND STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

ORDER NO. R-11573-B

ORDER OF THE NEW MEXICO OIL CONSERVATION COMMISSION

BY THE COMMISSION:

This case came before the Oil Conservation Commission (hereinafter referred to as "the Commission") on December 4, 2001 at Santa Fe, New Mexico, and the Commission, having carefully considered the evidence, the pleadings and other materials submitted by the parties hereto, now, on this 15th day of February, 2002,

FINDS,

1. Notice has been given of the application and the hearing on this matter, and the Commission has jurisdiction of the parties and the subject matter herein.

2. On October 23, 2001, Sun-West Oil and Gas Inc. (hereinafter referred to as "Sun-West") filed a timely application pursuant to NMSA 1978, § 70-2-13 for review *de novo* of Order No. R-11573-A of the Oil Conservation Division (hereinafter referred to as "the Division").

3. Order No. R-11573-A provided that the undivided interest owned by Sun-West was to be treated as an unleased mineral interest for the purpose of applying ordering Paragraphs (8), (11) and (12) of Division Order No. R-11573.

EXHIBIT
tabbies
"A"

4. The Commission's review *de novo* is thus limited to whether Sun-West's interest should be treated as an unleased mineral interest for purposes of ordering paragraphs (8), (11) and (12) of Order No. R-11573 as the Division ordered.

5. The parties stipulated that the record of the Division proceedings would be treated as the Commission's factual record. During the hearing of December 4, 2001, the Commission took official notice of those proceedings but also requested that Sun-West produce additional evidence of its relationship with Gulf Coast. Sun-West accordingly submitted the Affidavit of Shane Spear, President of Sun-West Oil & Gas Inc. and Gulf Coast Oil and Gas Company. Mr. Spears' affidavit should also become a part of the record of this matter.

6. The facts, apparently largely undisputed,[1] are as follows:

a. the Division, in Order No. R-11573, ordered the compulsory pooling of uncommitted mineral interests from the surface to the base of the Undesignated South Flying "M" Bough Pool underlying Lots 3 and 4 (W/2 SW/4 equivalent) in Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico;

b. Bettis, Boyle & Stovall, the applicant for compulsory pooling, proposed to dedicate the pooled acreage to its McGuffin "C" Well No. 1, which it proposed to drill at a standard location in Section 30;

c. at the time the application was filed, Sun-West owned an unleased and undivided 15% mineral interest in Section 30 and had not agreed to voluntary pooling;

d. Bettis, Boyle and Stovall attempted to reach an agreement with Sun-West prior to filing of the application, but Sun-West agreed to lease its interest to Bettis, Boyle & Stovall only for a 25% royalty and additional bonus;

e. when Sun-West failed to agree to voluntary pooling on acceptable terms, Bettis, Boyle and Stovall, on January 30, 2001, filed an application with the Oil Conservation Division for compulsory pooling;

f. notice of the filing of the application of Bettis, Boyle and Stovall and of the hearing thereon was sent by certified mail and received by Sun-West on February 6, 2001;

g. on February 15, 2001, Sun-West executed a lease of its interest in the lands that were the subject of the application in this case to Gulf Coast, reserving to itself a royalty of 27.5%;

[1] Sun-West disputed the finding of the Division that Sun-West and Gulf Coast are affiliates and the findings that the royalty interest reserved to Sun-West rendered the proposed well uneconomic.

h. only the lands within the unit at issue here were included in the lease to Gulf Coast;

i. Sun-West did not participate in the compulsory pooling hearing and appeared through counsel during the second hearing on the re-opened application, but presented no testimony;

j. Bettis, Boyle & Stovall's engineer, Bruce A. Stubbs, testified that Sun-West's 27.5% overriding royalty interest made drilling the McGuffin "C" Well No. 1 unfavorable and undesirable. He testified that while the proposed well would have marginal economics using a 3/16 royalty and yield a 28.13% rate of return before taxes and a 20% rate of return after taxes, a 1/4 royalty would yield a rate of return of 19.18% before taxes. He testified that a well will not be drilled when the rate of return is below 20%;

k. Order No. R-11573 provided for recovery out of production attributable to the interest of non-consenting working interest owners of reasonable well costs of the proposed McGuffin "C" Well No. 1, together with an additional 200% of these costs as a charge for the risk involved in drilling the well;

l. Order No. R-11573 further provided, in ordering paragraph (12), that "[a]ny well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests";

m. on May 3, 2001, Bettis, Boyle and Stovall, apparently having learned of the Sun-West lease to Gulf Coast, filed an application to reopen the case "for the purpose of amending Division Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the non-consent penalty";

n. during the hearing on the application to re-open, Bettis, Boyle and Stovall sought an order permitting it to recover the portion of well costs and of the 200% risk penalty attributable to the mineral interest of Sun-West out of 87.5% of production attributable to such interest as though Sun-West's interest were unleased;

o. Sun-West Oil & Gas Inc. is a Subchapter S corporation incorporated in the State of Texas on December 9, 1991 and its principal place of business is in Hobbs, New Mexico;

p. Gulf Coast is a subchapter C corporation incorporated in Delaware on November 6, 1980 and its principal place of business is in Midland, Texas. Gulf Coast has neither drilled nor operated wells in New Mexico;

q. Shane Spear is the President of both Sun-West and Gulf Coast but the two corporations have differing stock ownership;

r. Sun-West and Gulf Coast share a telephone number and address, and you speak to the same person when you discuss business matters with Sun-West or Gulf Coast;

s. when Bettis, Boyle and Stovall sought to contact Gulf Coast to negotiate terms of pooling, the individual who contacted Bettis, Boyle and Stovall to negotiate on behalf of Gulf Coast was the same individual with whom Applicant had previously discussed leasing of this interest from Sun-West; and

t. the interest of Sun-West in the proposed units was an unleased mineral interest on January 30, 2001, when an application for compulsory pooling of all interests therein was filed, and on February 6, 2001, when Sun-West received notice of the application. The interest of Sun-West was a leased interest as of the dates of the Division's orders.

7. On these facts, Bettis, Boyle & Stovall argued to the Commission that Sun-West's private contract with Gulf Coast improperly sought to avoid the jurisdiction of the Division and the Commission[2] to impose compulsory pooling in appropriate circumstances. Bettis, Boyle & Stovall argued that, but for the lease to Gulf Coast, the Oil and Gas Act would treat Sun-West's interest as an unleased mineral interest with a statutory 1/8 royalty interest and a 7/8 working interest, and the working interest would have been subject to the costs of drilling the McGuffin "C" Unit No. 1 plus a 200% risk penalty. Bettis, Boyle & Stovall claimed that the private contract with Gulf Coast was intended to avoid this result. Bettis, Boyle & Stovall further argued such private contracts could avoid the Division's jurisdiction by permitting a party to free a larger percentage of its interest from the costs of the drilling and create a smaller interest upon which the risk penalty would apply. The net effect of these actions, Bettis, Boyle & Stovall argued, is to reduce the Division's authority under the Oil and Gas Act, and to risk or impair the ability of the party pooling the acreage to produce a viable well because of the fundamental change in the economics wrought by the private contract.

8. Sun-West claimed that the Oil and Gas Act does not permit the Division to retroactively declare its royalty interest unleased. Sun-West claimed that such action would reduce the royalty interest, resulting in a partial taking of its interest and a complete taking of Gulf Coast's interest. Sun-West also claimed that the leasing of its interest was not taken to circumvent the jurisdiction of the Division and that substantial

[2] Further references to "the Division" are also to the Commission. See NMSA 1978, § 70-2-6(B).

evidence is lacking for a finding that Sun-West and Gulf Coast are affiliates. Sun-West also claimed that the Division's consideration of pooling applications is "standardless" and the Division's Order was [illegible] arbitrary; Sun-West's argument in this regard was based on its reading of Division cases cited as precedent by Bettis, Boyle & Stovall. Sun-West also claims that the Division's Order is not supported by substantial evidence because evidence is lacking to make a finding that the project was not economically viable. Finally, Sun-West claims that Order No. R-11573-A operated retroactively because it related back to the date of filing of the pooling application, not the time of the actual pooling (the entry of the pooling order).

9. It would circumvent the purposes of the Oil and Gas Act to permit a party owning an unleased mineral interest in a spacing unit at the time said party is served with an application for compulsory pooling to avoid the cost recovery and risk penalty provisions of the Act by leasing or otherwise burdening or reducing that interest after the application is filed with the Division and notice is served on the party.

10. Under certain circumstances, leasing, burdening or otherwise carving out a large non-cost-bearing interest may violate the correlative rights of interest owners and create waste if the non-cost-bearing interest is so large as to affect the economic viability of a prospect and prevent the drilling of a well.

11. The Division has repeatedly cautioned parties about carving out excessive non-cost-bearing interests. See R-7335 (interest owners created 50% overriding royalties in conveyances to their son and daughter, and the Division ordered either a voluntary reduction in the overriding royalties or that they be excluded from the proration unit); R-7998 (similar facts and result); R-12087 (a net profits interest carved out by an owner that would unnecessarily burden the project was found to be liable for its proportionate share of drilling and production costs and the risk penalty).

12. The record indicates that the lease to Gulf Coast was intended to circumvent the Division's pooling authority and that the 27.5% royalty interest reserved to Sun-West made the proposed McGuffin "C" Well No. 1 uneconomic and undesirable, threatened the correlative rights of other interest owners and threatens waste.

13. On the first point, uncontroverted evidence[3] indicates that the lease to Gulf Coast was intended to circumvent the Division's pooling authority. For example, counsel for Sun-West drafted and disseminated an article entitled "Compulsory Pooling in New Mexico." That article states that "... parties that anticipate compulsory pooling of their interests *may want to consider carving out or conveying a non-cost bearing burden prior to compulsory pooling. In this way parties being pooled can enhance their position.*" A copy of the relevant portions of the article were presented as a demonstrative aid by counsel for Bettis, Boyle & Stovall without objection during the hearing of December 4, 2001, and the Commission takes official notice of a copy of the article.

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[3] Sun-West presented no evidence during the three hearings conducted in this matter.

14. The lease of Sun-West's interest to Gulf Coast for a 27.5% royalty strongly suggests implementation of the strategy outlined by Sun-West's attorney in the aforementioned article.

15. Further corroborating is the fact that the non-cost-bearing burden carved out by Sun-West was even greater than the burden demanded by Sun-West of Bettis, Boyle and Stovall during negotiations, and Sun-West carved out and conveyed to Gulf Coast only that portion of its property subject to the pooling application.

16. The timing of the lease (shortly after service of the application for compulsory pooling) is also highly suggestive, as is the fact that Gulf Coast has not drilled or operated wells in New Mexico heretofore, and the close relationship of the two corporations, evidenced by the service of Mr. Spear as President of both and the representation of both by the same individuals. While it is evident that the corporations are separate legal entities, the close relationship of the corporations provided Sun-West a convenient means to implement the strategy described.

17. On the second point, the transaction between Sun-West and Gulf Coast implicates correlative rights and threatens waste. The lease would protect 27.5% of Sun-West's interest from having to bear the costs of drilling and the 200% risk penalty. As the McGuffin "C" Well No. 1 was a marginal economic prospect to begin with, if Sun-West's reserved royalty interest means the well is not drilled and resources underlying Section 30 not recovered, interest owners would be deprived of their statutory opportunity to recover the oil and gas underlying Section 30.

18. Protection of correlative rights and prevention of waste are critical functions of the Division. See NMSA 1978, § 70-2-11. Its authority to regulate in matters relating to conservation of oil and gas production is very broad. NMSA 1978, § 70-2-6.

19. The Oil and Gas Act permits the Division to order compulsory pooling of interests when voluntary efforts are unsuccessful. NMSA 1978, § 70-2-17(C). Section 17 authorizes the Division to require that non-participating parties bear their proportionate share of the costs of development and operations, plus a risk penalty up to 200%. Id. Such orders must be on such terms as are "fair and reasonable," and must protect the opportunity of interest owners to recover or receive without unnecessary expense their fair share of the oil or gas or both. The Oil and Gas Act unambiguously provides that an unleased interest involved in compulsory pooling is treated as being a 1/8 royalty interest and a 7/8 working interest. Id.

20. It appears that a non-cost-bearing burden of 27.5% would render drilling of the McGuffin "C" Well No. 1 unlikely. As noted previously, Bettis, Boyle & Stovall's expert testified that while the proposed well would have marginal economics using a 3/16 royalty interest and yield a 28.13% rate of return after taxes and a 20% rate of return after taxes, a 25% royalty would yield a rate of return of 19.18% *before taxes*. Bettis, Boyle & Stovall's expert testified that a well will not be drilled when the rate of return is below

20% and that Sun-West's higher overriding royalty interest through the Gulf Coast lease made the well unfavorable and undesirable. — but ≠ uneconomic

21. If the McGuffin "C" Well No. 1 is not drilled as a result of Sun-West's conduct, the correlative rights of the other interest owners would be violated and resources would be left in the earth and wasted.

22. The foregoing argues in favor of treating Sun-West's interest as unleased as ordered by the Division.

23. Sun-West's argument that the Division lacks authority to treat Sun-West's interest as unleased is incorrect for the reasons stated in paragraphs 18 and 19.

24. Sun-West's argument that Order No. R-11573-A creates a partial taking of Sun-West's interest and a complete taking of Gulf Coast's interest is misplaced. It is well established that private contracts in derogation of an oil and gas conservation statute are not enforceable, and that a regulatory body that refuses to recognize such a contract is not taking property in violation of a state constitution or the federal Constitution. Patterson v. Stanolind Oil and Gas Co., 182 Okla. 155, 77 P.2d 83 (Okla. 1938). Sun-West did not tender any evidence to this body tending to support its allegation of a taking; in most cases regulatory action becomes a "taking" only when a property owner is deprived of all or substantially all of the use of the property. Here, a reduced royalty would seem to have the opposite effect given the testimony of Bettis, Boyle & Stovall that the McGuffin "C" Well No. 1 would not be drilled. Reducing non-cost-bearing interests in appropriate circumstances is a well-recognized regulatory tool to ensure that waste is prevented and correlative rights are protected. See 5 Williams & Myers, Oil and Gas Law, § 944, page 680 (2000).

25. Sun-West's argument that the Division's review of compulsory pooling applications is "standardless" and therefore arbitrary is misplaced and based upon a misreading of prior Division cases. The Oil and Gas Act provides detailed standards for examination of applications for compulsory pooling, all of which were considered by the Hearing Examiner in this case and were addressed in detailed findings and conclusions in Order No. R-11573. The cases cited in paragraph 11, above, show that the Division has treated excessive non-cost-bearing interests consistently for many years.

26. Sun-West's argument that no evidence exists that the project was uneconomic also fails. Bruce A. Stubbs testified that a return of less than 20% after taxes results in "unacceptable economics" and "unfavorable economics" and that the higher royalty of the Sun-West lease created a rate of return of 19.18% percent *before taxes*. This more than establishes that the project is not economically viable. Sun-West presented no testimony on this or any other subject and Mr. Stubbs' testimony appears to support the proposition advanced.

27. Sun-West's argument that Order No. R-11573-A operates "retroactively" because it "relates back" to the date of filing of the pooling application, not the time of the actual pooling (the entry of the pooling order) is not valid because it assumes that the jurisdiction of the Division does not attach until issuance of an order. The jurisdiction of the Division attaches once an application for compulsory pooling is filed and the parties are properly served. If Sun-West's premise, that jurisdiction did not attach until the order was issued, is accepted, compulsory pooling could become a process without end and subject to severe abuse.

28. In order to effect pooling of the subject unit on terms that are just and reasonable under these circumstances, and to allow Bettis, Boyle & Stovall the opportunity to recover or receive without unnecessary expense its just and fair share of the oil or gas or both underlying the subject unit, the interest of Sun-West should be treated as an unleased mineral interest for the purpose of applying the cost recovery and risk charge provisions of Division Order No. R-11573.

29. Due to the delay occasioned by the *de novo* review of Order No. R-11573-A, the time for commencement of Applicant's McGuffin "C" Well No. 1, as provided in ordering paragraph (2) of Division Order No. R-11573, should be extended to May 15, 2002.

30. In all other respects, Division Orders No. R-11573 and R-11573-A should remain in full force and effect.

31. The Commission has not been asked to address, nor should it address, any issue regarding rights or duties as between Sun-West and Gulf Coast.

CONCLUSION OF LAW:

The Commission concludes that the authority expressly conferred on the Division and the Commission by the Oil and Gas Act is cumulative and not exclusive, and that the Commission and the Division have authority pursuant to NMSA 1978, §§ 70-2-11(A) and 70-2-17(C) to permit recovery of costs and risk charges out of production attributable to a non-expense-bearing interest where necessary to effect pooling upon terms that are fair and reasonable and to protect correlative rights and prevent waste, at least with respect to interests created subsequent to attachment of the Division's jurisdiction.

IT IS THEREFORE ORDERED:

1. The interest of Sun-West shall be treated as an unleased mineral interest for the purpose of applying ordering Paragraphs (8), (11) and (12) of Division Order No. R-11573.

2. The date for the commencement of Applicant's McGuffin "C" Well No. 1, as provided in Ordering Paragraph (2) of Division Order No. R-11573, is hereby extended to May 15, 2002.

3. In the event the operator does not commence drilling the well on or before May 15, 2002, Ordering Paragraph (2) of Order No. R-11573 shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

4. To the extent not in conflict with this Order, Division Orders No. R-11573 and R-11573-A are hereby confirmed and shall be and remain in full force and effect.

5. Jurisdiction of this case is retained for the entry of such further orders as the Commission may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

LORI WROTENBERY, CHAIR

JAMI BAILEY, MEMBER

ROBERT LEE, MEMBER

S E A L

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April 17, 2002

Florene Davidson, Commission Secretary
New Mexico Energy, Minerals & Natural Resources Department
Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: *Sun-West Oil and Gas, Inc. v. New Mexico Conservation Commission, et al*

Dear Ms. Davidson:

Pursuant to Rule 74(C), NMRA 2002, enclosed is a copy of the Notice of Appeal filed by Sun-West Oil and Gas, Inc. in the referenced matter which has been endorsed by the Clerk of the District Court.

Sincerely,

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

SDI:ljc
Enclosure
cc: William F. Carr

D-K025

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William F. Carr

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02 APR 22 AM 9:30
OIL CONSERVATION DIV.

April 22, 2002

HAND DELIVERED

Ms. Lori Wrotenbery, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Re: Oil Conservation Division Case No. 12601: Application of Bettis, Boyle and Stovall to reopen Case 12601 and amend Division Order No. R-11573 to address the appropriate royalty burdes on the proposed well for the purposes of the charge for risk involved in drilling said well, Lea County, New Mexico.

Dear Ms Wrotenbery:

Oil Conservation Division Order No. R-11573-B entered in the above-referenced case on February 15, 2002 extended the time for the commencement of the McGuffin "C" Well No. 1 on the pooled spacing unit comprised of Lots 3 and 4 of Section 30, Township 9 South, Range 33 East, NMPM to May 15, 2002 and declared that the interests of Sun-West Oil and Gas Inc. be treated as an unleased mineral interest for the purpose of this pooling order. This order provides that this pooling order shall be of no effect if the well is not commenced by May 15, 2002 or the order extended for good cause. This case has now been appealed by Sun-West and we understand that the Commission needs to submit the record on appeal on April 26, 2002.

This letter is to advise the Commission that due to the delays experienced in obtaining a final approval in the above-referenced case, the decline in gas prices during this time period with the possibility of further delay pending appeal have caused Bettis, Boyle and Stovall to decided not to drill the subject well. We will not request that Order No. R- 11573-B be extended when the pooling authority therein expires on May 15, 2002.

Accordingly, we believe that the issues which are the subject of the appeal are now moot and that the appeal should be dismissed.

Very truly yours,

William F. Carr

cc: C. Mark Maloney
Bettis, Boyle and Stovall, Inc.

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Wayne Christian
Bettis, Boyle and Stovall, Inc.

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To:	Stephen C. Ross New Mexico Oil Conservation Commission
Fax Number:	(505) 476-3462
Regarding:	*Sun-West Oil and Gas, Inc. v. New Mexico Conservation Commission, et al.*
From:	Stephen D. Ingram
Date:	April 30, 2002

Number of Pages (Including Cover Sheet): 2

Message:

Our File No.: **451.001**

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April 30, 2002

VIA FACSIMILE
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Stephen C. Ross, Assistant General Counsel
Oil Conservation Commission
New Mexico Department of Energy, Minerals and Natural Resources
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: *Sun-West Oil and Gas, Inc. v. New Mexico Oil Conservation Commission and Bettis, Boyle & Stovall*
First Judicial District No. D-101-CV2002-00752

Dear Mr. Ross:

This letter is sent to you on behalf of my client, Sun-West Oil and Gas, Inc., in connection with the above-referenced appeal. I am in receipt of a copy of counsel for Bettis, Boyle & Stovall's letter to the Oil Conservation Division in which he advises that his client does not intend to request that Order No. R-11573-B be extended when the pooling authority therein expires on May 15, 2002, for the reason that his client has decided not to drill the McGuffin Well made the subject of this pooling proceeding. However, Mr. Carr's letter does not formally withdraw Bettis, Boyle & Stovall's well proposal and pooling application. Mr. Carr's letter therefore does not have the effect of mooting this appeal. By my calculations, the OCC must file the record on appeal in accordance with Rule 74(H), NMRA 2002 on May 20, 2002. So that my client's interests are not prejudiced, we would request that the OCC take such steps as necessary to prepare and file the record on appeal. We will, of course, cooperate with the OCC with regard to the preparation and filing of the record.

Thank you for your cooperation in this matter. If you have any questions, please contact the undersigned.

Sincerely,

STRATTON & CAVIN, P.A.

By: _____
Stephen D. Ingram

SDI:ljc
cc: William F. Carr

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